FILED

No. 94- 947 JUN 30 1994

IN THE OFFICE OF THE CLERK

Supreme Court of the United States

OCTOBER TERM, 1994

WEST PENN POWER COMPANY,
ARMCO ADVANCED MATERIALS COMPANY
and ALLEGHENY LUDLUM CORPORATION,
Petitioners,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
NORTH BRANCH ENERGY PARTNERS, L.P. and
MON VALLEY ENERGY CORPORATION,
Respondents.

Petition for a Writ of Certiorari to the Commonwealth Court of Pennsylvania

---

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

WILLIAM J. MURPHY
(Counsel of Record)
JOHN J. CONNOLLY
MURPHY & SHAFFER
Suite 750
100 Light Street
Baltimore, Maryland 21202
(410) 752-1564
Counsel for Petitioners

THOMAS K. HENDERSON
PATRICIA J. CLARK
MICHAEL D. MCDOWELL
WEST PENN POWER COMPANY
800 Cabin Hill Drive
Greensburg, PA 15601
(412) 837-3000
Of Counsel for Petitioner West Penn Power Company

DAVID F. BOEHM
MICHAEL L. KURTZ
BOEHM, KURTZ & LOWRY
2110 Society Bank Center
36 East Seventh Street
Cincinnati, Ohio 45202
(513) 421-2255
Of Counsel for Petitioners Armco Advanced Materials Company and Allegheny Ludlum Corporation

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

340 pp

APPENDIX
TABLE OF CONTENTS

		Page
A.	Orders of Pennsylvania Supreme Court, entered April 4, 1994, denying petitions for allowance of appeal filed by West Penn Power Company	1a
B.	Orders of Pennsylvania Supreme Court, entered April 4, 1994, denying petitions for allowance of appeal filed by Armco Advanced Materials Company and Allegheny Ludlum Corporation	4a
C.	Opinion and Order of Commonwealth Court of Pennsylvania, filed July 15, 1993	7a
D.	Order of Commonwealth Court, entered August 3, 1993, dismissing applications for reargument	23a
E.	Order of Commonwealth Court, entered September 21, 1993, denying renewed applications for reargument	24a
F.	Opinion and Order of the Pennsylvania Public Utility Commission, entered November 24, 1992	25a
G.	Opinion and Order on Remand of the Public Utility Commission, entered July 6, 1992	39a
H.	Tentative Opinion and Order of Public Utility Commission, entered July 8, 1988	47a
I.	Order of Public Utility Commission, entered September 30, 1988, consolidating proceedings	97a
J.	Opinion and Order on Reconsideration of the Public Utility Commission, entered January 19, 1989	105a
K.	Recommended Decision of Administrative Law Judge Public Utility Commission, issued June 27, 1989	116a
L.	Appendix A to Recommended Decision of June 27, 1989 (pages 60-67 of West Penn Power Company's Main Brief filed May 16, 1989)	220a
M.	Motion to Adopt Administrative Law Judge's Recommended Decision, including dissenting and concurring statements, before Public Utility Commission, dated September 21, 1989	226a

TABLE OF CONTENTS—Continued

		Page
N.	Order of Public Utility Commission, entered September 29, 1989	239a
O.	Dissenting Opinion of Public Utility Commissioner Fischl, dated October 6, 1989	290a
P.	Order of Public Utility Commission, denying petition for reconsideration, entered October 27, 1989	295a
Q.	Opinion and Orders of Commonwealth Court, filed September 7, 1990	299a
R.	Order of Pennsylvania Supreme Court, entered November 19, 1991, denying petitions for allowance of appeal	321a
S.	Order of Pennsylvania Supreme Court, entered February 3, 1992, denying applications for reconsideration	322a
T.	Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3	323a
U.	Regulations adopted by the Federal Energy Regulatory Commission under Section 210 of PURPA, 18 C.F.R. §§ 292.301 & 304 (1993)	331a
V.	Regulations adopted by the Pennsylvania Public Utility Commission Implementing PURPA, 52 Pa. Code § 57.32 (1983)	336a

APPENDIX A

THE SUPREME COURT OF PENNSYLVANIA
WESTERN DISTRICT

CHARLES W. JOHNS, ESQUIRE
Prothonotary
IRMA T. GARDNER
Deputy Prothonotary

801 City-County Building
Pittsburgh, Pa.
15219-2463
(412) 565-2816

April 4, 1994

Michael D. McDowell, Esquire
WEST PENN POWER COMPANY
800 Cabin Hill Drive
Greensburg, PA 15601

In Re: Armco Advanced Materials Corporation and Allegheny Ludlum Corporation v. Pennsylvania Public Utility Commission

West Penn Power Company, Petitioner v. Pennsylvania Public Utility Commission

No. 0577 W. D. Allocatur Docket 1993

Dear Mr. McDowell:

The Court has entered the following Order on your Petition for Allowance of Appeal filed in the above-captioned matter:

"PER CURIAM

AND NOW, this 4th day of April, 1994, the Petition for Allowance of Appeal is denied.

Mr. Justice Montemuro is sitting by designation as Senior Justice pursuant to Judicial Assignment Docket No. 94 R1800, due to the unavailability of Mr. Justice Larsen, see No. 127 Judicial Administration Docket No. 1, filed October 28, 1993."

Very truly yours,

/s/ Irma T. Gardner
Deputy Prothonotary

THE SUPREME COURT OF PENNSYLVANIA
WESTERN DISTRICT

CHARLES W. JOHNS, ESQUIRE
Prothonotary
IRMA T. GARDNER
Deputy Prothonotary

801 City-County Building
Pittsburgh, Pa.
15219-2463
(412) 565-2816

April 4, 1994

Michael D. McDowell, Esquire
West Penn Power Company
800 Cabin Hill Drive
Greensburg, PA 15601

Terrence McVerry, Esquire
Grogan Graffam McGinley & Lucchino, P.C.
Three Gateway Center, 22nd Floor
Pittsburgh, PA 15222

In Re: Armco Advanced Materials Corp., et al. v. P.U.C.
West Penn Power Company v. P.U.C.
No. 0462 W. D. Allocatur Docket 1993

Gentlemen:

The Court has entered the following Order on your Petition for Allowance of Appeal, Motion for Admission Pro Hac Vice and Motion of Intervenor to Expedite Review of Petitions for Allowance of Appeal in the above-captioned matter:

"PER CURIAM

AND NOW, this 4th day of April, 1994, the Petition for Allowance of Appeal is denied. The Motion for Admission Pro Hac Vice and the Motion of Intervenor to Expedite Review of the Petitions for Allowance of Appeal are granted.

Mr. Justice Montemuro is sitting by designation as Senior Justice pursuant to Judicial Assignment Docket No. 94 R1800, due to the unavailability of

Mr. Justice Larsen, see No. 127 Judicial Administration Docket No. 1, filed October 28, 1993."

Very truly yours,

/s/ Irma T. Gardner
Deputy Prothonotary

APPENDIX B

THE SUPREME COURT OF PENNSYLVANIA
WESTERN DISTRICT

CHARLES W. JOHNS, ESQUIRE
Prothonotary
IRMA T. GARDNER
Deputy Prothonotary

801 City-County Building
Pittsburgh, Pa.
15219-2463
(412) 565-2816

April 4, 199-

David F. Boehm, Esquire
Michael L. Kurtz, Esquire
2110 Society Bank Center
Cincinnati, OH 45202

Terrence McVerry, Esquire
Grogan Graffam McGinley & Lucchino, P.C.
Three Gateway Center,
22nd Floor
Pittsburgh, PA 15222

In Re: Armco Advanced Materials Corp., et al. v. P.U.C.
West Penn Power Company v. P.U.C.
No. 0596 W. D. Allocatur Docket 1993

Gentlemen:

The Court has entered the following Order on your Petition for Allowance of Appeal in the above-captioned matter:

"PER CURIAM

AND NOW, this 4th day of April, 1994, the Petition for Allowance of Appeal is denied.

Mr. Justice Montemuro is sitting by designation as Senior Justice pursuant to Judicial Assignment Docket No. 94 R1800, due to the unavailability of Mr. Justice Larsen, see No. 127 Judicial Administration Docket No. 1, filed October 28, 1993."

Very truly yours,

/s/ Irma T. Gardner
Deputy Prothonotary

THE SUPREME COURT OF PENNSYLVANIA
WESTERN DISTRICT

CHARLES W. JOHNS, ESQUIRE
Prothonotary
IRMA T. GARDNER
Deputy Prothonotary

801 City-County Building
Pittsburgh, Pa.
15219-2463
(412) 565-2816

April 4, 1994

Terrence F. McVerry, Esquire
Grogan, Graffam, McGinley & Lucchino, P.C.
Three Gateway Center,
22nd Floor
Pittsburgh, PA 15222

Marvin A. Fein, Esquire
Houston Harbaugh, P.C.
12th Floor,
Two Chatham Center
Pittsburgh, PA 15219

In Re: Armco Advanced Materials Corporation and Allegheny Ludlum Corporation, Petitioners v. Pennsylvania Public Utility Commission

West Penn Power Company v. Pennsylvania Public Utility Commission

No. 0457 W. D. Allocatur Docket 1993

Dear Mr. McVerry and Mr. Fein:

The Court has entered the following Order on your Petition for Allowance of Appeal, Motion for Admission Pro Hac Vice and Motion of Intervenor to Expedite Review of the Petitions for Allowance of Appeal filed in the above-captioned matter:

"PER CURIAM

AND NOW, this 4th day of April, 1994, the Petition for Allowance of Appeal is denied. The Motion for Admission Pro Hac Vice and the Motion of Intervenor to Expedite Review of the Petitions for Allowance of Appeal are granted.

Mr. Justice Montemuro is sitting by designation as Senior Justice pursuant to Judicial Assignment

Docket No. 94 R1800, due to the unavailability of Mr. Justice Larsen, see No. 127 Judicial Administration Docket No. 1, filed October 28, 1993."

Very truly yours,

/s/ Irma T. Gardner
Deputy Prothonotary

APPENDIX C

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 2742 C.D. 1992

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

No. 2755 C.D. 1992

WEST PENN POWER COMPANY,
Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

Argued: May 10, 1993

Before: HONORABLE JOSEPH T. DOYLE, Judge
HONORABLE DAN PELLEGRINI, Judge
HONORABLE GEORGE T. KELTON, Senior Judge

OPINION BY JUDGE PELLEGRINI

FILED: July 15, 1993

West Penn Power Company (West Penn) and two of its large industrial customers, Armco Advanced Materials Corporation and Allegheny Ludlum Corporation (Industrials), have filed consolidated appeals from an order of

the Pennsylvania Public Utility Commission (PUC) adopting from North Branch Energy Partners, L.P. (North Branch) rather than from West Penn, the recalculation of avoided cost as of October 15, 1987, relative to the purchase of power by West Penn from the Burgettstown Project.

As with most cases involving purchase power agreements, this appeal has a long history with unexpected twists and turns. It arises as a result of the remand order we issued in *Armco Advanced Materials Corporation and Allegheny Ludlum Corporation, et al. v. Pennsylvania Public Utility Commission* (Nos. 2090 and 2097 C.D. 1989, filed September 7, 1990), *petition for allowance of appeal denied*, No. 31 W.D. allocator Docket 1990 (November 19, 1991), *petition for reconsideration denied*, (February 3, 1992) (*Burgettstown I*). In that case, North Branch proposed to build and operate a qualifying cogeneration facility (QF)[1] in Robinson Township, Washington County (Burgettstown Project), capable of providing up to 80 megawatts (MW) of power for 33 years. The QF would be fueled by coal waste located at the project site.

In 1985, North Branch began "serious negotiations" with West Penn to sell it capacity from its proposed power plant. Negotiations continued for more than two years, and on October 15, 1987, the parties executed an electric energy purchase agreement (EEPA). That agreement provided that the avoided cost rate would be 3.6 cents per kilowatt hour (kwh) based upon West Penn's avoided cost as of October 6, 1986, also the time of serious negotiations between the parties, with an expected in-service date of October, 1991. West Penn's decision

---

[1] Section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. § 796(18)(A), defines a cogeneration facility as one which produces electric energy and steam or forms of useful energy (such as heat) which are used for industrial and commercial heating or cooling purposes.

to enter into the EEPA was based on its future anticipated need to purchase electric power, as determined by West Penn's parent company, the Allegheny Power System (APS).

On January 5, 1988, West Penn filed a petition with the PUC requesting approval of the EEPA and of rate recovery from its ratepayers. The petition also requested that the PUC provide notice and a comment period to satisfy the due process rights of ratepayers. The Industrials filed a petition to intervene arguing that the EEPA should not be approved because the avoided cost rate was excessive. Without providing for the requested notice or a comment period, the PUC issued an order on September 29, 1988, approving the EEPA based on West Penn's avoided cost calculated at the time of serious negotiations on October 6, 1986, and authorizing rate recovery of costs.

After the PUC entered its order, this court in *Barasch v. Pennsylvania Public Utility Commission*, 119 Pa. Commonwealth 81, 546 A.2d 1296, *reargument denied*, 119 Pa. Commonwealth Ct. 115, 550 A.2d 257 (1988), *petition for allowance of appeal denied*, 657 W.D. Allocator Docket 1988 (October 19, 1989) (*Milesburg I*), held that before the PUC could approve a contract for a utility's purchase of power from a QF which involved substantial payments for such capacity, due process required that the utility's customers be provided with notice of the proceedings and an opportunity to be heard because substantial property rights were involved.

Pursuant to our holding in *Barasch*, the PUC withdrew its order, consolidated several appeals regarding other similar projects [2] and heard the Burgettstown Project approval petition. Subsequently, North Branch filed a petition requesting a modification of the EEPA, stating that

---

[2] Those other QF cases simultaneously heard included the Milesburg, Shannopin and Monongahela Lock and Dam power plants.

because of delays in the approval petition, it would not be able to meet the existing financing closing date of October 1, 1989. North Branch requested the PUC to modify the EEPA by setting the closing date as six months from the date of a final order of the PUC in the proceeding and adjusting other milestone dates accordingly. The modification petition also requested an increase in the agreed upon avoided cost of 3.6 cents/kwh to 4.65 cents/kwh based on the change of the in-service date from October of 1991 to January of 1993 due to litigation delays.

At the hearings, the Administrative Law Judge (ALJ) bifurcated the proceedings into two phases. Phase One concerned issues relating to the capacity rates to be paid to North Branch, and Phase Two concerned issues raised by North Branch's modification petition. The ALJ issued a recommended decision approving the capacity rate of 3.6 cents/kwh based upon West Penn's avoided cost as of October 6, 1986, the time of serious negotiations between the parties.

As to the Phase Two issues, the ALJ recommended that North Branch's modification petition be denied because, while the delays caused by the litigation were not foreseen, the parties had voluntarily agreed to various risks in the original negotiations and in the EEPA.[3] By order dated September 29, 1989, the PUC adopted the ALJ's recommendations as to Phase One issues approving the EEPA between West Penn and North Branch and recovery of costs through the energy cost rate at the time of serious negotiations. However, the PUC reversed the ALJ's recommendation and granted North Branch's modification petition, stating that if it were denied, the EEPA would expire by its own terms on October 1, 1989, and

---

[3] North Branch filed a motion for reconsideration of the ALJ's decision which was denied. Contemporaneously with that filing, North Branch withdrew its request for an increase in the capacity credit.

would send the erroneous message to those opposing future QFs that they could win by default merely by the passage of time. Because North Branch had previously withdrawn its request for an increase in its avoided cost, the PUC did not address that issue.

The Industrials filed an appeal with this court from the PUC's decision. They argued that the PUC's policy of calculating avoided costs as of the time of serious negotiations was invalid pursuant to 18 C.F.R. § 292.304 (d), which required avoided cost to be calculated at the time a legally enforceable obligation was incurred. Further, due to tax changes occurring between 1986 and 1987, the payment to North Branch should be modified to reflect those changes. West Penn also argued that the PUC had improperly extended the milestone dates for the Burgettstown Project and the EEPA had expired by its own terms.

We determined that the PUC had properly exercised its authority in ordering a modification of the contract milestone dates.[4] We also agreed that avoided cost was to be calculated as of the time that a legally enforceable obligation was incurred by North Branch to deliver capacity to West Penn, and that date was October 15, 1987,

---

[4] We did so because West Penn's challenges to the PUC's order regarding the milestone dates were without merit. West Penn first argued that the PUC failed to make the determination required by Section 508 of the Public Utility Code, 66 Pa. C.S. § 508, that the milestone dates were contrary or adverse to the public interest. However, while Section 508 gives the PUC the power to modify contract terms, the PUC did not exercise its power under state law, but rather under Section 210 of PURPA, 16 U.S.C. § 824a-3, which creates a federal statutory duty requiring utilities to purchase energy from QFs. As such, the PUC's action dealt with the utility's public service obligation as required by PURPA. West Penn also argued that the PUC erred by ordering indefinite milestone dates because fixed dates are necessary to protect West Penn and its ratepayers. However, the PUC did not eliminate milestone dates, but rather moved them forward to allow for litigation delays so as to comport with our decision in *Milesburg I*.

when the EEPA was signed. We then issued an order remanding the case to the PUC to make a new calculation of avoided cost using factors in existence at the time the EEPA was executed rather than at the time of serious negotiations.[5]

Pursuant to our remand order, the PUC directed the parties to submit a recalculation of avoided cost using all avoided cost inputs as of the time of the legally enforceable obligation.[6] Without the benefit of an evidentiary hearing, North Branch, West Penn and the Industrials submitted their recalculations to the PUC. North Branch's recalculation based on all avoided cost inputs from the time of the legally enforceable obligation increased the agreed upon 3.6 cents/kwh to 4.91 cents/kwh based on an in-service date of July 1, 1994 (with a range up to 5.71 cents/kwh based on an in-service date of October 1, 1995 or later). West Penn's recalculation using all avoided cost inputs as of October 15, 1987, went from the agreed upon 3.6 cents/kwh down to zero based on its determination that the capacity needs forecasted by APS in 1986 had totally diminished by October of 1987. The Industrials submitted the expert testimony of Stephen J. Baron who relied on planning documents available as

---

[5] West Penn and the Industrials filed a petition for allowance of appeal with the Pennsylvania Supreme Court. A cross-appeal was filed by the PUC. By order dated November 19, 1991, both appeals were denied. The parties then filed petitions for reconsideration before this court which were also denied by order dated February 3, 1992.

[6] For an unknown reason, the PUC also requested the parties to submit a recalculation of avoided costs using the tax rates from the time North Branch incurred a legally enforceable obligation on October 15, 1987, but using all other avoided cost inputs as of the time of serious negotiations. North Branch's recalculation under that constraint ranged from 5.15 cents/kwh to 6.06 cents/kwh, and West Penn's recalculation ranged from 4.89 cents/kwh to 5.75 cents/kwh.

of October 15, 1987, and also argued that West Penn had no need to purchase power in 1987.[7]

By order dated November 24, 1992, the PUC rejected both West Penn's and the Industrials' submittals indicating that West Penn had no capacity need. The PUC stated that West Penn's argument was inconsistent with the very act of signing the EEPA, and found meritless both parties' contention that West Penn's capacity needs had changed from 900 MW of additional capacity, as projected in 1986 based on APS plans to build a 900 MW plant, to zero by October 15, 1987. Moreover, the PUC noted that this issue had already been determined in the companion case of *West Penn Power Company, et al. v. Pennsylvania Public Utility Commission*, —— Pa. Commonwealth Ct. ——, 615 A.2d 951 (1992), *reargument denied*, November 10, 1992, *petitions for allowance of appeal filed* at Nos. 663 and 672 W.D. Docket 1992 (*Shannopin II*),[8] where this court held that a hindsight determination of a change in capacity need was not to be considered when recalculating avoided cost as of the date the legally enforceable obligation was incurred.

---

[7] He argued, though, that if power was needed as of that date, the recalculated avoided cost would range from .69 cents/kwh with an in-service date of July 1, 1994, to .81 cents/kwh with an in-service date of October 1, 1995.

[8] That first case involving the Shannopin power plant was *Armco Advanced Materials Corporation and Allegheny Ludlum Corporation v. Pennsylvania Public Utility Commission* (No. 2091 C.D. 1989, July 17, 1991), *petition for allowance of appeal denied*, No. 545 W.D. Allocator Docket 1990 (November 19, 1991) (*Shannopin I*). Similar to the proceedings below in this case, that case also determined that avoided costs had to be calculated as of the time a legally enforceable obligation had been incurred rather than at the time of serious negotiations. Because that had not been done, we issued a remand order requiring the PUC to recalculate such costs as of the date the contract was signed between the parties.

The PUC then stated, in its order that it accepted North Branch's recalculation of avoided cost, which only considered inputs at the time of the legally enforceable obligation.[9] Those figures indicated varying capacity rates from 4.91 cents/kwh with an in-service date of July, 1994, to 5.71 cents/kwh with an in-service date of October 1, 1995. The PUC also indicated in its order that the financing closing date would be six months from the date that the PUC's order became final and nonappealable, and that the other milestone dates were to be adjusted accordingly. These consolidated appeals by West Penn and the Industrials followed.

I.

West Penn and the Industials' core contention is that the PUC erred by accepting North Branch's recalculation of avoided cost rather than West Penn's or the Industrials' because they provided sufficient evidence that North Branch's power was excess power as of October 15, 1987. West Penn contends that its figures now establish that the power is unneeded and the PUC erred in refusing to consider the evidence it offered. The Industrials contend that the evidence it offered was credible, and that it established on October 15, 1987, the date the EEPA was signed, that a reasonable person would have known that the power was excess capacity.[10]

---

[9] North Branch's recalculation was based on changes in the federal and state tax rates, the cost of money, construction costs and the fixed change rate for coal generation facilities, and the continued capacity need for the power it was to produce.

[10] West Penn also argues that the PUC erred by dismissing four additional documents it wished to place into evidence regarding its change in capacity need because they were obtained after the EEPA was signed and were not part of the original hearing record. As such, West Penn believes that because the only evidence of record goes to the date of serious negotiations in 1986, of which the PUC took judicial notice, there was no evidence as to change in factors as of 1987. However, these documents were excluded because the PUC determined that they did not support or explain the recalculations made by West Penn.

Not totally unexpected because it had projected the need for the power when it signed the EEPA, West Penn relied totally on information it gleaned after the date of the legally enforceable obligation. It argues that use of such information was proper because it is a more accurate reflection of its power need. As to the date which should be used to calculate avoided cost, we stated in *West Penn Power Company et al. v. Pennsylvania Public Utility Commission*, —— Pa. Commonwealth Ct. ——, —— A.2d —— (Nos. 1147, 1148 C.D. 1992, filed March 10, 1993) (*Shannopin III*), that the PUC had to base its avoided cost calculation on whether the capacity was needed on factors *known as of the date the legally enforceable obligation was incurred.*[11] In that case, the issue was whether the PUC improperly implemented our remand order in *Shannopin I* by only recalculating corporate tax rates as of the date there was a legally enforceable obligation, and not recalculating all other factors as of that date which made up the avoided cost. We determined that the PUC had erred because our order anticipated a recalculation encompassing *all* avoided cost figures as of October 15, 1987. "Because a determination of whether an avoided cost element of the capacity cost credit is fair is based on time sensitive data, the PUC cannot change just one element to obtain an accurate calculation. It has to make that determination as if that calculation had not been made before and examine all the elements that determine avoided cost [as of October 15, 1987]." *Id.*, at slip opinion p. 11.

Moreover, in *Shannopin II*, West Penn and the Industrials also argued that based on hindsight information, West Penn no longer had any need to purchase capacity produced from the Shannopin Mine Project. In that case, we expressly rejected the use of the hindsight informa-

[11] The standard used by the PUC was whether a reasonable person could have discerned or should have discerned on October 15, 1987, that power was or was not needed and the amount of avoided cost based upon inputs available as of that date.

tion because if there was no litigational delay and the agreement became effective when signed, neither the utility nor ratepayers would be able to challenge the agreement. At least as to QFs, time was frozen when the EEPA became effective, and all calculations had to be made as of that date. *Shannopin III*. Because the recalculation of avoided cost had to be based on information known as of that date, and West Penn's evidence was based on hindsight, the PUC properly excluded its recalculation.[12]

As to the Industrials' recalculation based on its expert's testimony purportedly using inputs as of October 15, 1987, that West Penn did not need any new baseline capacity,[13] the PUC rejected that opinion because it simply did not find the expert credible. The PUC stated:

---

[12] As West Penn recognized, to adopt its position, we would be required to overrule our decision in *Shannopin II* where we held that even if it was determined based on hindsight information after the EEPA was signed that power was no longer needed, ratepayers were required to pay for that power. The dissent to that opinion (Pellegrini, J., joined by Smith, J. and Friedman, J.), however, would have allowed a change in capacity need based on that type of information in fairness to the ratepayers who would be saddled with paying for the excess power as opposed to the utility that signed the agreement.

[13] Stephen Baron testified as follows before the PUC:

> Q. Are you relying on hindsight to determine today what could have, or should have been known, as of the contract signing date?
>
> A. No. All of the information that I have relied upon is extracted from planning documents available to all parties at or around the October 15, 1987 time of the contract signing. These documents include the Company's Integrated Resource Plan as well as the testimonies of intervenors which reflected the realities of the planning environment at that time. A review of the extensive record in this case clearly shows that by the time of the October 15, 1987 contract signing date, the Company's need for and timing of new capacity as well as the

> [T]he testimony is inconsistent with that presented by the same witness in the proceedings in chief in March of 1989. Specifically, although Armco/Allegheny had previously disagreed with a number of elements of the original West Penn calculations, it's witness in 1989 testimony *presumed* the use of a *base load coal plant* although he *now* suggests that as of October, 1987, the proper unit to use was a combustion turbine. [T]he Armco/Allegheny witness also changed a number of other factors for purposes of this proceeding, although he contends that both sets of figures were appropriate for October 15, 1987.

(PUC Opinion and Order dated November 24, 1992, at pp. 8-9.)

The PUC is empowered to make credibility determinations of the evidence presented. *Pennsylvania Electric Company v. Pennsylvania Public Utility Commission*, 81 Pa. Commonwealth Ct. 285, 473 A.2d 704 (1984). In this case, the PUC found the Industrials' expert's testimony as to West Penn's capacity need as of October 15, 1987, not credible. As such, the evidence offered by the Industrials was insufficient evidence to prove that West Penn had no need to purchase capacity when it signed the EEPA. Because North Branch's recalculation was the only recalculation submitted based only upon factors known to them as of October 15, 1987, the PUC did not act improperly by accepting that recalculation.

II.

West Penn and the Industrials argue next that the PUC improperly interfered with an internal management decision made by West Penn that it no longer needed any

---

type and cost of new capacity had changed significantly from the earlier period defined as the time of serious negotiations.

(Reproduced Record at p. 1655a.)

capacity when it determined that West Penn had future capacity needs as agreed to in the EEPA signed on October 15, 1987. Citing *Pennsylvania Public Utility Commission v. Philadelphia Electric Company*, 522 Pa. 338, 561 A.2d 1224 (1989), they contend that the management decisions regarding a power plant are to be left to the utility, and the PUC cannot interfere with those decisions unless there has been an abuse of discretion. However, here the PUC did not interfere with a management decision to purchase power, it just refused to allow West Penn to back out of an agreement to purchase power.

West Penn made an internal management decision that it had future need to purchase power, and acknowledged this need formally when it signed the EEPA on October 15, 1987. The parties to that agreement requested the PUC to approve its terms, which the PUC did with modifications for litigation delay. Because West Penn legally agreed it had capacity needs to be met at future dates, it cannot now point to the PUC and claim interference with that decision just because, in hindsight, it believes it made an erroneous decision.[14] Because the PUC, in keeping with the above-cited cases, is only requiring that West Penn not change the terms of the original EEPA regarding capacity need based on hindsight information, we find there has been no interference by the PUC on this recent decision made by West Penn.[15]

---

[14] Where the PUC determines that a utility as opposed to a QF is producing excess capacity, it may exclude the value of the property producing the excess from the rate base and disallow the utility's return on that property. *See* Section 1310(d) of the Public Utility Code, 66 Pa. C.S. § 1310(d). However, when the PUC approves an EEPA between a QF and a utility, the risk of excess capacity is shifted to the ratepayers who are required to pay for it even if it later is determined it is not needed.

[15] Moreover, PURPA requires interference with managerial decisions as far as contracts are concerned when a QF has energy to sell and a utility has a need to purchase energy. Section 210(a) of PURPA, 16 U.S.C. § 824a-3, which was designed to lessen the

III.

West Penn and the Industrials also argue that North Branch waived its right to request an increase from the agreed upon avoided cost of 3.6 cents/kwh to its recalculation ranging from 4.91 cents/kwh to 5.71 cents/kwh. They contend that North Branch withdrew that request with its contemporaneous filing of its petition for reconsideration of the ALJ's decision denying its request for contract modification and increased avoided cost. While it is true that North Branch voluntarily withdrew its request for an increase in the capacity rate, this court's remand order specifically required a recalculation of the rate to be paid to the QF by the utility as of October 15, 1987, the date of the legally enforceable obligation. Anything which transpired prior to that date, including North Branch's withdrawal of its request, is irrelevant for purposes of complying with that order.[16]

IV.

Finally, West Penn and the Industrials argue that the PUC erred by failing to grant their request for an evidentiary hearing on the recalculation of avoided cost so that they could provide additional evidence regarding the dramatic change in West Penn's capacity need as of October 15, 1987. They also contend that West Penn's customers were entitled to be informed of the recalculation so that their concerns could be heard as well.

In *Milesburg I*, this court determined that due process required a hearing be held regarding approval of the

---

dependence of electric utilities on foreign oil and natural gas by encouraging the development of alternative power sources in the form of QFs, provides that the PUC shall prescribe such rules as necessary to encourage QFs to sell electric energy and electric utilities to purchase that energy from such facility.

[16] Similarly, had North Branch's request remained in place and received the PUC's approval, the avoided cost approved would also have been subject to recalculation as of the date the EEPA was signed.

original contract terms for a utility's purchase of power from a QF that included payments for capacity. We stated that while a full, trial-type of hearing was not required, "the commission must devise a procedure that provides the essential elements of a hearing, but allows for consideration of petitions of the type involved here in as expeditious and minimally burdensome a manner as possible.[17] *Id.*, 119 Pa. Commonwealth Ct. at 105, 546 A.2d at 1307. In *Armco Advanced Materials Corporation, et al v. Pennsylvania Public Utility Commission*, 135 Pa. Commonwealth Ct. 15, 579 A.2d 1337 (1990) (*Milesburg II*), *reargument denied*, September 13, 1990, *petition for allowance of appeal granted*, —— Pa. ——, 600 A.2d 539, 542, 543 (1991), which dealt with the remand order regarding the recalculation as of the date of a legally enforceable obligation, we further determined that a rehearing on the recalculations submitted by the parties was *not* required. Relying on our decision in *Milesburg II*, as well as on the fact that a hearing was never requested by either West Penn or the Industrials, we find that the PUC did not err by not holding an evidentiary hearing on the recalculations submitted in this case.

Regarding the issue of notice, West Penn's customers were not entitled to any notice of the recalculation of

---

[17] In *Milesburg I*, we also stated that the PUC should make its own calculations of avoided cost part of the record and should provide access of those calculations to interested parties prior to the "hearing." Under PURPA regulation 18 C.F.R. § 292.304(d)(2), the PUC has an absolute duty to determine whether the avoided cost component of the capacity cost agreed to by the utility and the QF is at or below the full avoided cost and is "just and reasonable" to the ratepayers. The PUC is obligated to fulfill this requirement by making its own calculation of the avoided cost on the record and comparing that figure to the contract rates. Although the PUC was required to make its own calculation of the maximum allowable avoided cost in this case as well, there is no indication in the record that the PUC did so. However, because no one raised that matter on appeal, that issue is not before us.

avoided cost because they never intervened in the original proceeding to contest any of the terms of the EEPA. Had they done so, they would have been a party to the ongoing litigation. However, having been given notice and choosing not to intervene, they were not entitled to notice of the recalculations.

Consequently, because West Penn and the Industrials failed to comply with the PUC's order to submit recalculations of its avoided cost only using inputs known as of October 15, 1987, the PUC was within its authority to accept North Branch's recalculations as of that date so as to comply with our remand order issued in *Burgettstown I*. Accordingly, the decision of the PUC is affirmed.

/s/ Dan Pellegrini
DAN PELLEGRINI
Judge

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 2742 C.D. 1992

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

No. 2755 C.D. 1992

WEST PENN POWER COMPANY,
Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

ORDER

AND NOW, this 15th day of July, 1993, the order of the Pennsylvania Public Utility Commission dated November 24, 1992, No. P-889284, is affirmed.

/s/ Dan Pellegrini
DAN PELLEGRINI
Judge

APPENDIX D

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 2742 C.D. 1992

ARMCO ADVANCED MATERIALS CORPORATION *et al.*,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

No. 2755 C.D. 1992

WEST PENN POWER COMPANY,
Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

ORDER

PER CURIAM

NOW, August 3, 1993, upon consideration of West Penn Power Company's application for reargument and Armco Advanced Materials Corporation and Allegheny Ludlum Corporation's application for reargument, and it appearing that said applications were filed on July 30, 1993, and that said applications seek reargument of an order of this court dated July 15, 1993, and it further appearing that said applications are untimely filed, see Pa. R.A.P. 2542, 2547, the applications are dismissed as untimely filed.

APPENDIX E

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 2742 C.D. 1992

ARMCO ADVANCED MATERIALS CORPORATION *et al.*,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

No. 2755 C.D. 1992

WEST PENN POWER COMPANY,
Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

ORDER

PER CURIAM

NOW, September 21, 1993, upon consideration of (1) Armco Advanced Material's application for enlargement of time; (2) Armco's application for reargument of August 3, 1993 order; and (3) West Penn Power Company's application for reargument nunc pro tunc or for enlargement of time, the applications are denied.

Judge McGinley did not participate in the decisions concerning these applications.

APPENDIX F

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held November 24, 1992

Commissioners Present: David W. Rolka, Chairman
Joseph Rhodes, Jr.,
Vice-Chairman
Wendell F. Holland,
Commissioner

Docket No. P-880284

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENT FOR ORDER GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS (BURGETTSTOWN PROJECT)

OPINION AND ORDER

BY THE COMMISSION:

By our opinion and order on remand entered July 6, 1992, we directed that the parties to this proceeding carry out the Commonwealth Court's September 7, 1990 order (remanding the proceedings to the Commission) by submitting for our consideration calculations of payments to be made to North Branch Energy Partners, L.P. (North Branch or Burgettstown) for power purchases from that facility. The calculations were to use West Penn Power Company's "avoided cost" methodology, but were to reflect two scenarios, one with changes to such

costs due only to tax law changes in effect as of October 15, 1987, and one with calculations changing all inputs as of that date. We also required that calculations be made based on various in-service dates for the project beginning with July 1, 1994 through October 1, 1995. Our order of July 6, 1992 set forth the history of these proceedings to the date of that order, so we will only recite subsequent events. We also indicated that upon receipt of the calculations and any responses thereto, the Commission would enter a final order in these proceedings, which we now do.

By submittal dated July 27, 1992, North Branch provided its calculations indicating what it contends is the appropriate recalculation of the capacity rate under the two scenarios, reflecting modifications due only to tax law changes effective as of October 15, 1987 and reflecting recalculations with additional input modifications as of that date. Armco Advanced Materials Corporation and Allegheny Ludlum Corporation (Armco/Allegheny) submitted, also under date of July 27, 1992, the "testimony" of its consultant, which it contends reflects appropriate recalculations. However, once again Armco/Allegheny has failed to comply with the Commission's directive that it make one set of such calculations modified only to reflect tax law changes, as indicated in our July 6 order. Instead, it has performed recalculations based on the assumption that West Penn had no capacity need in October of 1987, a position rejected in the Commission order entered May 22, 1992, in the companion case concerning the Shannopin Mine Project, Docket No. P-880286.

By submittal dated July 29, 1992, West Penn Power Company (West Penn) provided recalculations based on its view of tax law changes as well as recalculations based on its view that it had no capacity need when it signed the instant contract on October 15, 1987. On August 5, 1992, Armco/Allegheny forwarded certain corrections to

its previously submitted calculations. Under date of August 17, 1992, North Branch responded to the calculations proposed by West Penn and Armco/Allegheny. In turn, West Penn and Armco/Allegheny both filed responses to the North Branch calculations, on August 19, 1992.

Discussion

This is a proceeding resulting from appeals of the original Commission order of September 29, 1989, approving the terms of the power purchase agreement between West Penn and North Branch, dated October 15, 1987. In those consolidated appeals, *West Penn Power Company v. Pa. P.U.C.*, No. 2097, C.D. 1989, and *Armco Advanced Materials Corporation and Allegheny Ludlum Corporation v. Pa. P.U.C.*, No. 2090 C.D. 1989, filed September 7, 1990, *Opinion not reported* (*Burgettstown I*), Commonwealth Court remanded the proceedings to the Commission for the very limited and specific purpose of having a recalculation of the capacity payments to North Branch. These recalculations were to be done without the necessity of evidentiary hearings. By no means did the Court suggest the remand proceeding be expanded to consider matters not presented in the original appeal or matter beyond the scope of the recalculations. In the proceedings on the original appeal before Commonwealth Court, Armco/Allegheny argued that the capacity payment to North Branch should be modified to reflect tax law changes occurring between 1986 and 1987. Specifically, Armco/Allegheny argued that since the contract was not signed until October 15, 1987, a price agreement reached earlier which did not reflect tax rates that had been lowered by October of 1987, did not represent an accurate calculation of avoided costs. *Nothing* in the Armco/Allegheny brief, filed in 1990, suggested that there had been no capacity need as of October 15, 1987 (Armco/Allegheny's brief in *Burgettstown I*, pages 43-50). West Penn in turn in its presentation to Common-

wealth Court did not make any arguments that calculations of avoided costs should be made as of October 15, 1987, since it contended that the Commission had improperly extended the milestone dates for the North Branch project and thus that the contract had by its terms expired.

The Commonwealth Court determined that the Commission had correctly exercised its authority under PURPA in ordering a modification of the contract to provide for financing closing dates six months after the entry of a final, non-appealable order in the instant case, as well as other milestone extensions. *Burgettstown I*, Slip Opinion p. 20. While West Penn argued strenuously that the Commission's order was invalid, it *did not* present any claim that it had no capacity need as of October 15, 1987. In fact, in contending that the Commission should not have extended the milestone dates, West Penn asserted that the lack of assurance that the project would be completed might place West Penn and its ratepayers in jeopardy of not having sufficient capacity: "If this qualifying facility is not built, and if West Penn does not have time to develop other capacity, West Penn may not have sufficient capacity to reliably serve its customers in the future." West Penn brief in *Burgettstown I*, p. 40. It must be noted that this argument was presented in February of 1990.

Contrary to its previous position, West Penn in the proceedings on remand has now for the first time asserted that in fact it had no need for capacity over the ten-year period starting on the date of contract signing, October 15, 1987. This argument however is inconsistent with the very act of contract signing, as well as being inconsistent with various filings made with the Commission which demonstrate that West Penn *included* the capacity from the Burgettstown project, as well as those of the companion Shannopin and Milesburg projects, in plans to meet the utility's ten-year capacity needs, at least for

several years after the signing of those contracts. Armco/Allegheny has also asserted for the first time that as of October 15, 1987 West Penn had no need for capacity within the next ten years. We found these arguments had no merit in our order on remand in the companion case of the Shannopin project, Docket No. P-880286, entered May 22, 1992.

In remanding the instant case, the Commonwealth Court directed that there be a new calculation of capacity cost credit, using the West Penn methodology but using inputs appropriate for October 15, 1987. Additionally, the Court directed that the financing closing dates and all other milestone dates should be adjusted as the Commission's original order had set forth. The Court clearly envisioned that new evidentiary hearings would not be necessary and that written calculations and any objections to such calculations would suffice. The Court also indicated that since this was a question of first impression, a decision should have only prospective effect (*Burgettstown I*, Slip Opinion pgs. 20-21). As we discussed in our Shannopin order of May 22, 1992, the only arguments presented by Armco/Allegheny to the Commonwealth Court as a rationale for recalculating the price to be paid to qualifying facilities were that tax law changes required such a recalculation. Since no other party had appealed the Commission's decision involving the Shannopin project, and since the Commonwealth Court's opinion in that case specifically indicated only that the recalculations should reflect changes in tax laws, our May 22 Shannopin order adopted the recalculation using *only* modifications due to tax law changes. We believe that considering only tax law changes would also be appropriate here, as we have previously indicated. Nonetheless, we must note that the Court's opinion in the instant case did not specifically mention tax law changes. We are also mindful of the fact that Armco/Allegheny and West Penn appealed from our order in the Shannopin remand proceedings, causing further delay in the progress

of that project. For those reasons, although we in no way wish to indicate that approving recalculations considering only tax law changes in the instant case would be improper, we will in this particular proceeding consider changes to other calculation inputs, as described below.

Armco/Allegheny has again failed to submit recalculations of the payments to North Branch reflecting tax law changes as of October 15, 1987, although Armco/Allegheny had argued *only* that tax law changes necessitated recalculating the payments. It has now changed its position, in the remand proceedings, and has advanced the wholly new argument that West Penn had no need for capacity on the date that it signed the agreement to purchase capacity from North Branch. Armco/Allegheny made the same argument in the remand of *Armco Advanced Materials Corp. and Allegheny Ludlum Corp. v. Pa. P.U.C.* (No. 2091 C.D. 1989, filed July 17, 1990, opinion not reported) (*Shannopin I*). The Commission determined in that remand that Armco/Allegheny's position was not tenable. Both Armco/Allegheny and West Penn appealed to Commonwealth Court from that remand decision. (*West Penn Power Co. v. Pa. P.U.C.*, 1147 C.D. 1992 and *Armco Advanced Material Corp. et al v. Pa. P.U.C.*, 1148 C.D. 1992, argument heard October 21, 1992) (Shannopin III). Armco/Allegheny has ignored Commonwealth Court's holding in *this* proceeding affirming the Commission's prior decision that both the coal proxy and the West Penn methodology were appropriate. Armco/Allegheny also has ignored the fact that it had not asserted a West Penn lack of capacity prior to these proceedings on remand, now arguing for the first time matters that were never asserted in the case in chief. As we indicated in our Shannopin order on remand, such newly conceived arguments have been waived and are not within the scope of the Commonwealth Court's order remanding these proceedings.

Armco/Allegheny has also claimed that payments for North Branch capacity would constitute an unjustifiable rate increase, a claim which is in fact completely contradicted by the evidence in the proceeding in chief before the Commission and the recalculations submitted here. Armco/Allegheny reaches this wholly unsupportable claim by simply multiplying the highest possible payment times the highest potential output of the facility, which of course erroneously assumes that any utility-owned capacity (or capacity purchased from other sources) would have a zero cost. Such clearly erroneous assertions are not helpful in seeking to determine the proper price to be paid North Branch, on terms consistent with the Commission's original order and the Commonwealth Court's remand in these proceedings.

As North Branch has noted in its response to the Armco/Allegheny "testimony", the testimony is inconsistent with that presented by the same witness in the proceedings in chief in March of 1989. Specifically, although Armco/Allegheny had previously disagreed with a number of elements of the original West Penn calculations,[1] it's witness in 1989 testimony *presumed* the use of a *base load coal plant* although he *now* suggests that as of October 1987, the proper unit to use was a combustion turbine. As North Branch further notes, the Armco/Allegheny witness also changed a number of other factors for purposes of this proceeding, although he contends that both sets of figures were appropriate for October 15, 1987. We must therefore agree with North Branch that even were the Armco/Allegheny "testimony" relevant to this proceeding, we could not find it to be credible.

Turning to the West Penn submittals, we note that West Penn did comply with our directives that it submit

---

[1] Armco/Allegheny did not pursue its disagreement with West Penn's original methodology in the Armco/Allegheny appeal to Commonwealth Court. Thus no such issues are present in this proceeding.

two sets of calculations, one reflecting modifications due only to tax law changes and the other its claim as to the appropriate inputs for October 15, 1987. West Penn's "all-inputs" recalculation, however, is based on the erroneous and unsupported assertion that in fact West Penn had no capacity need over the ten-year period starting in October of 1987. We note that West Penn has provided twenty-four attachments to its submittal, several of which do not appear to have been part of the original record, nor do they appear to be public documents available to all parties to this proceeding, nor do they support or explain the calculations made by West Penn. Attachments 10, 11, 15 and 16 particularly appear to fall into this category. North Branch also has attached, as exhibit 3 to its response, portions of a document that do not appear to have been of record in this proceeding. While we do not find consideration of these documents necessary to our determination in this case, and note that these are not clearly public documents of which the Commission could take judicial notice, it does not appear that the West Penn submittals support the proposition for which they are advanced anyway. West Penn has contended that Attachment 10, (its internal guidelines for utility employees dealing with qualify facilities), somehow shows that it should not have signed the contract with North Branch. The document in fact indicates that even qualifying facilities which have not signed contracts, but have reached agreement with the utility on rates, would be included in utility integrated resource plans.

While West Penn has included as attachments to its submittal certain portions of its required annual "PURPA § 210" filings with the Commission (Attachments 12 and 13), the Commission will take judicial notice of the entire filings for the years 1986 through 1992. Examination of filings made in 1987 indicates that the total number of qualifying facilities planned as additions to the Allegheny Power System (APS) were to allow APS (the system of which West Penn is a part) to meet system

capacity needs without adding additional coal-fired units, i.e., the qualifying facility capacity was intended to displace the need for APS building any utility-owned coal-fired facilities over the next ten years.

Form 2 of the 1988 and 1989 filings specifically indicate that West Penn (and APS) were planning on the addition of the Milesburg, Burgettstown and Shannopin projects to meet capacity needs for the future. In fact, Form 2 of the 1990 filing reflects the first time that West Penn removed the Burgettstown and Milesburg projects from the planned capacity additions. A footnote to those filings indicates that they were removed because, in West Penn's view, the agreements had terminated, although the footnote does indicate those matters were still being litigated.

Additionally, as North Branch has noted, West Penn testimony in this proceeding in 1989 indicated that the APS annual resource plan for *1988* first showed future capacity additions as including combustion turbines (North Branch response, page 7). North Branch also notes that the *November 2, 1987* "resource plan" (West Penn Attachment 11) has only recently been offered by West Penn to stand for the proposition that the utility intended to add combustion turbines in the future. We note that adding combustion turbines in the future, according to this "plan", was contingent *upon having the capacity additions offered by these three projects*, as set forth on the third page of Attachment 11 to West Penn's submittal. That document indicates that West Penn specifically was relying on the Milesburg project and two other 80 MW projects, i.e., Burgettstown and Shannopin, to meet its future capacity needs. North Branch also refers to interrogatory answers provided by West Penn in these proceedings in chief, as of 1989, indicated that in 1987 West Penn had *not* planned on meeting future capacity needs by the addition of combustion turbines.

As we previously stated, we do not believe that West Penn's Attachments 15 and 16 are acceptable demonstrative evidence in this proceeding. However, those attachments together with Attachment 17 do indicate the misleading nature of West Penn's claims—Attachment 16 purports to show West Penn's capacity needs with "PURPA projects" removed, yet the Milesburg project is retained in Attachment 16. Conversely, Attachment 17 is a portion of West Penn's 1990 "Integrated Resource Plan", and contains capacity from the Shannopin project but not the Milesburg or Burgettstown projects. If any of these attachments demonstrate anything, it is that West Penn (and APS) originally intended to replace 900 MW of coal-fired capacity with a large number of qualifying facilities, and that many of those qualifying facilities have not yet been completed, thus *increasing* West Penn's need for capacity.

West Penn has attempted to justify removing only the Pennsylvania qualifying facilities from its capacity plans because, as it states at pgs. 10-11 of its submittal, West Virginia and Maryland have not required that previously agreed upon rates be recalculated as of the date of contract signing. Even though the Commonwealth Court decision in this proceeding has caused a disadvantage to Pennsylvania qualifying facilities, it is wholly unreasonable to claim that projects with contracts signed in the same time-frame as those in other states should not go forward. In fact, it was the sum total of qualifying facilities in the three states that the APS system relied upon to displace its need for 900 MW of coal-fired capacity. Adverse court decisions and litigation delays by third parties cannot result in the claim that the Pennsylvania projects can now only replace a different type of utility plant addition different from that *planned* to be displaced by *all* contemporaneous projects. Further, even if there were otherwise merit to West Penn's claim that the proper avoided unit is a combustion turbine, which is not the case, that claim would be contrary to the

specific finding made by the Commission in its original order in this proceeding, wherein we held that the many advantages of the addition of coal-fired units in Pennsylvania compelled finding a coal unit to be the proper basis for capacity payments.

As we stated in our Shannopin order of May 22, 1992, the West Penn argument is circular. The planned additions from numerous qualifying facilities was the reason that West Penn could, in the late 1980's, plan on not having to add base-load coal-fired capacity. The change that occurred in its plans was that the coal-fired units were displaced by qualifying facilities. To now claim that West Penn does not need one or more of these projects because its plans showed the availability of capacity from those very same projects constitutes circular reasoning. West Penn has specifically made the claim that it does not need the Shannopin capacity, as well as the Burgettstown capacity. Since it has removed the Milesburg capacity from its 1990 filing with the Commission, it presumably would make the same argument with respect to the Milesburg project. Instead of finding the West Penn and Armco/Allegheny claims credible, we find that since several qualifying facility projects have been terminated or delayed, West Penn capacity needs are at least as great as when the contracts were signed. The Commission thus finds no merit in the recent contentions of Armco/Allegheny and West Penn that West Penn's capacity needs changed from 900 MW of additional capacity as projected in 1986, based on APS plans to build a 900 MW coal plant, to zero by October 15, 1987, when the capacity offset to the proposed utility plant, as clearly and unequivocally demonstrated from West Penn's own filings with this Commission, was to be achieved by capacity provided from a number of qualifying facilities, including 80 MW from the Burgettstown Project. It is wholly unreasonable for these parties to suggest that as of October 15, 1987, capacity was not needed over the next ten years as shown in capacity addition plans which *included*

the supply of over 200 MW of capacity from the very qualifying facilities from which West Penn now refuses to make purchases. That is not consistent with the original proceedings in this case and is not consistent with the Commonwealth Court order on remand.

We also must agree with North Branch that the claims of West Penn and Armco/Allegheny that payments to North Branch will result in huge amounts "in excess of avoided costs" are untrue—the figures claimed by West Penn and Armco/Allegheny assume that there will be no West Penn capacity need over the entire thirty-three year life of the Burgettstown Project, so that the total payments to North Branch reflect only a cost with no benefit. Of course that is not the case, and in fact the payments to North Branch represent a *discount* from the cost that West Penn would incur to add its own capacity with a similar useful life in the same time period.

Turning finally to the precise level of payments in the instant case, we determine that we will accept the figures offered by North Branch reflecting the changes for "all inputs" as of October 15, 1987. We do this with some misgivings, since we believe that approval of payments reflecting only tax law changes would be entirely appropriate in the instant proceeding and consistent with Commonwealth Court's directions on remand. Nonetheless, we recognize as a practical matter that this is an issue in the current appeal from the Shannopin remand proceedings, which Commonwealth Court has not addressed as of the date of this order. In an attempt to avoid uncertainty through further litigation delay, we will offer North Branch the opportunity to proceed on the basis of its calculation of "all inputs" changes. We do find that it is appropriate for the North Branch calculation to reflect the later in-service date of the project, due to litigation delays for which it was not responsible in any manner, thus we specifically accept the North Branch request for such updating. We find that North Branch's calculations

appropriately reflect all modifications due to tax law changes and that its calculations are acceptable as the proper calculations in this proceeding. It may well be that, due to further delay in this proceeding, only the October 1, 1995 in-service date is relevant. Since it appears that North Branch is willing to accept the numbers calculated for that in-service date, assuming it is able to reasonably proceed with the project, we also will accept the numbers for the October 1, 1995 in-service date. As indicated in the Commonwealth Court order, our previous decisions in this proceeding remain in effect in all respects beyond those addressed in this limited phase of the proceedings; THEREFORE,

IT IS ORDERED:

1. That the recalculations as set forth in the North Branch submittal of July 27, 1992, producing capacity rates varying from 4.9189 cents/kwh to 5.7106 cents/kwh, which concomitant project on-line dates ranging from July 1, 1994 through October 1, 1995 or thereafter are hereby accepted as the appropriate recalculation reflecting inputs modified as appropriate for the contract signing date of October 15, 1987.

2. That the contract previously entered by West Penn and North Branch shall remain in effect, with modifications as directed by the Commission in previous orders and further modifications herein, to reflect the above capacity rates, contingent upon the effective on-line date of the project.

3. That the financing closing date shall be six months from the date that the Commission's order herein becomes final and nonappealable, and that other milestone dates shall be adjusted accordingly.

4. That a copy of this order be served upon all parties to these proceedings.

5. That this proceeding be terminated.

BY THE COMMISSION,

/s/ John G. Alford
JOHN G. ALFORD
Secretary

(SEAL)

ORDERED ADOPTED: November 24, 1992
ORDER ENTERED: November 24, 1992

APPENDIX G

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265

Public Meeting held July 2, 1992

Commissioners Present: David W. Rolka, Chairman
Joseph Rhodes, Jr.,
Vice Chairman
Wendell F. Holland,
Commissioner

Docket No. P-880284

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENT AND FOR ORDER GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS (BURGETTSTOWN PROJECT).

OPINION AND ORDER ON REMAND

BY THE COMMISSION:

The issue before us for consideration in this part of the proceedings at Docket No. P-880284 concerns implementation of the remand of these proceedings to the Commission by the Commonwealth Court. On May 7, 199[illegible] North Branch Energy Partners, L.P. (North Branch) filed with the Commission a petition asking that the Commission implement the order of Commonwealth Court dated September 7, 1990. Commonwealth Court's order remanded the proceedings to the Commission for consideration of a change in calculating the amount to be paid

for the capacity portion of the purchase. Overall, the question has involved a West Penn Power Company (West Penn) purchase of electric energy from the Burgettstown Project, a qualifying facility to be developed by North Branch with power to be sold to West Penn. Unfortunately, the question of approval of this purchase has had an exceedingly long history before the Commission and appellate courts. Hopefully our action today will allow further development of the project.

After having negotiated with North Branch for a substantial period of time, West Penn entered into an electric energy purchase agreement (EEPA) with North Branch, under date of October 15, 1987. That agreement contained price terms that were derived prior to the Ocotber 15 date of the contract. On January 5, 1988 West Penn filed with the Commission a petition seeking an order that West Penn could pass through to its ratepayers all costs incurred under the agreement. Although we had issued a tentative order granting approval of the rates in the North Branch EEPA and rate recovery thereof, after adoption of that tentative order the Commonwealth Court entered its order in *Barasch v. Pa.P.U.C.*, 119 Pa. Commonwealth Ct. 81, 546 A.2d 1296 (1988) (*Milesburg I*). In *Milesburg I*, the Court required that where there are purchases of capacity from a qualifying facility and these purchases involve "substantial" payments for such capacity, at least the "essential elements" of a hearing on the contract should be provided if requested by an affected party. Therefore, we consolidated the question of approval of the purchase from North Branch with the Milesburg proceedings and proceedings involving purchases from several other qualifying facilities for hearing thereon.

By order entered September 29, 1989, the Commission approved the EEPA between West Penn and North Branch and recovery of those costs through the Energy Cost Rate (ECR). In the proceedings leading to that or-

der, Armco Advanced Materials Corporation and Allegheny Ludlum Corporation (Armco/Allegheny), two industrial customers of West Penn, had raised issues relating to the time of calculation of the capacity payment to be made to North Branch. Armco/Allegheny appealed the Commission's final order to Commonwealth Court. One of the issues raised by Armco/Allegheny was the contention that the capacity cost calculation was improper because it used tax rates in effect at the time of "serious negotiation," rather than tax rates in effect on the date borne by the contract. Armco/Allegheny advanced arguments *only* as to changes required due to changes in federal and state tax codes, i.e., it argued at length (Armco/Allegheny Commonwealth Court brief pp. 43-50) that changed tax laws required recalculating the capacity payment, but did *not* advance any *other* changes required as of October, 1987.

The Commonwealth Court remanded the case to the Commission and instructed that we calculate West Penn's full avoided cost according to West Penn's method but using inputs appropriate for the date which appears on the contract.[1] A petition for allowance of appeal from the Commonwealth Court order was filed with the Supreme Court of Pennsylvania by West Penn and Armco/Allegheny at No. 531 Allocatur Docket 1990. A cross-petition for allowance of appeal was filed by the Commission.

The Pennsylvania Supreme Court had not acted on the various petitions for allowance of appeal, so on May 7, 1991, North Branch filed with this Commission its petition for recalculation of the capacity cost credit, i.e., implementation of the Commonwealth Court remand directive which is the subject of this order. In its petition, North Branch alleged that the continuing delay of these

[1] West Penn had also appealed the Commission's opinion and order, but the West Penn appeal concerned issues not germane to this order.

proceedings, particularly the delay in performing this calculation, would impede the development of the project. North Branch requested that the Commission direct interested parties to submit proposed rate recalculations, using the West Penn methodology as contemplated by the Commonwealth Court, and including all inputs used in the recalculation. North Branch asked that the calculations be made reflecting different in-service dates of July 1, 1994 and for each quarter thereafter through October 1, 1995. North Branch further suggests that interested parties then be given the opportunity to file responses to the recalculation of other parties.

Armco/Allegheny on May 23, 1991, filed an answer and motion to dismiss the petition. The gist of Armco/Allegheny's pleadings is an argument that the Commission did not have jurisdiction to proceed while the Pennsylvania Supreme Court was considering whether to hear the appeals and that, contrary to the plain requirement in Commonwealth Court's order, further evidentiary hearings on the recalculations are required. On May 28, 1991 West Penn filed a motion to dismiss and answer, also alleging that the Commission lacks ability to proceed before Supreme Court action and arguing for further evidentiary hearings. On June 7, 1991 North Branch filed a response to the two motions to dismiss, noting that there had been no supersedeas of the Commonwealth Court order (none had been sought) and that neither West Penn nor Armco/Allegheny had sought review of the part of the Commonwealth Court order North Branch wanted to have implemented. On June 13, 1991 North Branch filed a motion to strike West Penn's "new matter," asserting that no further evidentiary hearings were necessary. In return, West Penn countered with a "reply" and argued that North Branch's motion was untimely.

On November 19, 1991, the Supreme Court of Pennsylvania denied the petitions for allowance of appeal filed by West Penn and Armco/Allegheny and the cross-peti-

tion for allowance of appeal filed by the Commission, thus effectively terminating the appeal from the Commonwealth Court decision. West Penn and the Commission filed petitions for reconsideration, which were denied by order dated February 3, 1992. On February 24, 1992, North Branch filed with the Commission an amended petition to implement Commonwealth Court's remand order. North Branch notes therein that the Commonwealth Court order is now final and again requests implementation thereof. North Branch also suggests that the Supreme Court decision in *Milesburg II* (appeals were accepted; argument not yet held) might affect the Burgettstown project.

Armco/Allegheny filed an answer to the amended petition on March 9, 1992, arguing that any Supreme Court action in *Milesburg II* would not affect this proceeding and that North Branch's previous withdrawal of its request to increase the capacity rate now precludes increases to reflect a later on-line date. West Penn also filed a motion to dismiss and answer to the amended petition. Therein West Penn asserted the Commission lacked jurisdiction, asserted that it might file a petition for writ of certiorari with the United States Supreme Court and asserted that further evidentiary hearings are necessary. On March 24, 1992, North Branch answered West Penn's "new matter," arguing that evidentiary hearings are unnecessary.

DISCUSSION

West Penn and Armco/Allegheny, in their original motions to dismiss, asserted that the Commission lacks "jurisdiction" to implement the direction contained in the Commonwealth Court order. As we discussed in our order concerning recalculations for the Shannopin project, (order entered December 5, 1991, at Docket No. P-880286), West Penn and Armco/Allegheny had no basis for arguing the Commission could not implement the

Commonwealth Court's order even pending Supreme Court review. Since it was West Penn and Armco/Allegheny who argued *for* the result set out in that part of the Court's order, those parties could have no conceivable reason for opposing recalculation of the capacity credit, except the hope that delay will cause project termination. We will not allow litigation delay to supersede determinations on the merits.

As for the contention that further evidentiary hearings are necessary, we think this is contrary to the clear statements in Commonwealth Court's order. We do agree with Armco/Allegheny's argument in its answer (filed March 9, 1991) to the amended petition, that any Supreme Court decision in *Milesburg II* will not affect this proceeding, since that Court denied the petitions for allowance of appeal in this case. West Penn's further argument that the Commission lacks jurisdiction over the subject matter, considering the express mandate of Commonwealth Court, has no basis.

Armco/Allegheny has raised the question of whether there may be, as part of the recalculations, any recalculation to reflect a later on-line date for the Burgettstown project. While we do not agree with Armco/Allegheny that North Branch's previous withdrawal of its modification request *precludes* "updating" to reflect the later on-line date, this issue of later on-line dates was not specifically addressed in the Court's order. Certainly North Branch has suffered the damages of litigation delays as have the other projects, so "updating" makes sense. As part of the submittals here, we will thus entertain a request for "updating" by North Branch, as well as arguments for or against such by the parties; these arguments should be concise. We will, however, direct submittal of the calculations with various on-line dates.

The last issue is whether calculations should reflect only changes due to state and federal tax law changes. Armco/Allegheny argued about the effects of such changes

at great length, but failed to mention any *other* change. The Commonwealth Court *did* specifically address this question in the Shannopin case, as we noted in our order entered December 5, 1991 in that proceeding. To be consistent, we believe use of tax-related adjustments only is appropriate here. However, we will direct the filing of calculations both with *all* inputs changed as of October 15, 1987 and with *only* tax-related changes. We will grant the petition of North Branch in this proceeding as modified; THEREFORE,

IT IS ORDERED:

1. That the petitions of North Branch Energy Partners, L.P., for recalculation of capacity cost credit are granted. Those petitions are tantamount to requesting implementation of Commonwealth Court's directions on remand, which implementation is hereby carried forth.

2. That the answers and motions to dismiss the North Branch Energy Partners, L.P., petition filed by West Penn Power Company and Armco Advanced Materials Corporation/Allegheny Ludlum Corporation are denied.

3. That in accord with the Commonwealth Court order, calculations of capacity credits payable to North Branch, using West Penn Power Company's methodology but using federal and state tax rates in effect on October 15, 1987, as well as calculations changing all inputs as of that date, shall be made by North Branch Energy Partners, L.P., West Penn Power Company and other affected parties and shall be submitted to the Commission within twenty (20) days of receipt of this order. Submittals should include full explanation of the calculations and assumptions.

4. That each calculation proposed in accord with paragraph three above should be made based on an in-service date of the Burgettstown project as of July 1, 1994 and the first day of each calendar quarter beginning October 1, 1994 and thereafter through October 1, 1995. If it so wishes, North Branch may specifically request that ca-

pacity credits be updated to reflect a later on-line date due to litigation delays.

5. That the recalculations thus submitted will become part of the record in accord with the Commonwealth Court's order. Parties shall serve the calculations upon all other parties, each of which may respond in writing thereto within twenty (20) days after receipt. Such responses shall also become part of the record.

6. That upon receipt of calculations and any responses, the Commission shall enter a final order herein.

7. That a copy of this order be served upon all parties to the proceedings at Docket No. P-880284.

BY THE COMMISSION,

/s/ John G. Alford
JOHN G. ALFORD
Secretary

(SEAL)

ORDER ADOPTED: July 2, 1992

ORDER ENTERED: July 6, 1992

* * * *

APPENDIX H

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held July 8, 1988

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice-Chairman
Linda C. Taliaferro
Joseph Rhodes, Jr.
Frank Fischl, dissenting

Docket Nos. P-880283
P-880284
P-880286

PETITIONS OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS

Re: MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

TENTATIVE OPINION AND ORDER

BY THE COMMISSION:

On December 31, 1987, January 5, 1988, and January 20, 1988 West Penn Power Company ("West Penn") filed petitions requesting approval of rate recovery of amounts

paid pursuant to power purchase agreements with the developers of the Monongahela Lock & Dam No. 8 Project ("Monongahela Project"), the Burgettstown Project, and the Shannopin Mine Project, respectively. The Monogahela Project is a proposed 5 MW hydroelectric project located near Point Marion in Fayette County, Pennsylvania, the developer of which is Noah Corporation, a South Carolina corporation. The Burgettstown Project is a proposed 80 MW [1] bituminous coal waste-fired cogeneration plant with two circulating fluidized bed boilers, one steam turbine generator and related facilities to be located in Robinson Township, Washington County, the developer of which is North Branch Energy Partners, L.P., a Delaware limited partnership with offices in Greensburg, Pennsylvania. The general partner of North Branch Energy Partners, L.P. is North Branch Energy, Inc., a Pennsylvania corporation. The Shannopin Mine Project is a proposed 80 MW [2] coal-fired cogeneration plant with a circulating fluidized bed boiler and related facilities to be located at Poland Mines in Greene County, the developer of which is Mon Valley Energy Corporation, a Pennsylvania corporation. As a condition precedent to West Penn's obligation to purchase energy or capacity, each of the three projects must be certified as a qualifying facility ("QF") under Sections 201 and 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 796(17) through (22) and 16 U.S.C. § 824a-3 (generally "PURPA 210") and the regulations of the Federal Energy Regulatory Commission ("FERC") implementing PURPA 210, 18 C.F.R. § 292.101 *et seq.* All three projects will be located in West Penn's service territory.

---

[1] The gross design capacity of the proposed Burgettstown Project will be approximately 91 MW; however the maximum contract output is defined in the power purchase agreement is 80 MW.

[2] The gross design capacity of the purposed Shannopin Mine Project will be approximately 89 MW; however the maximum contract output as defined in the power purchase agreement is 80 MW.

The power purchase agreement governing the Monongahela Project, dated June 15, 1987, provides, *inter alia,* for the purchase by West Penn of all energy and capacity produced by the project for a term commencing on or after January 1, 1992 and extending the term of the FERC license authorizing the operation of a hydroelectric generating station at the project's site. As a condition precedent to West Penn's obligations under the agreement, such FERC license must be issued no later than January 1, 1990. After the project's commencement date as defined in the agreement, the energy credit for the first fifteen years is 3.8 cents per kwh unless the balance in the tracking account established by the agreement is zero. After the fifteenth year, or during any time that the tracking account balance is zero, the energy credit is a variable equal to 3.8 cents per kwh plus one-half the difference between West Penn's avoided energy costs and 3.8 cents per kwh. The capacity credit is a fixed rate of 3.6 cents per kwh based on a 1992 in-service date of an avoided 300 MW coal plant, and is approximately equivalent to West Penn's estimate as of April 18, 1985 of the levelized present value of avoided capacity over the life of the project.

The power purchase agreement governing the Burgettstown Project, dated October 15, 1987, provides, *inter alia,* for the purchase by West Penn of all energy and capacity produced by the project for a term commencing on or after September 30, 1991 and extending thirty-three years following the project's commencement date as defined by the agreement. The energy credit is a variable rate based on West Penn's actual production costs at designated generating facilities. The capacity credit is a fixed rate of 3.6 cents per kwh based on a 1995 in-service date of an avoided 300 MW coal plant, and is slightly lower than West Penn's estimate as of October 6, 1986 of the levelized present value of avoided capacity over the life of the project.

The power purchase agreement governing the Shannopin Project, dated October 15, 1987, provides, *inter alia,* for the purchase by West Penn of all energy and capacity produced by the project for a term commencing on or after August 31, 1992 and extending thirty years following the project's commencement date as defined by the agreement. The energy credit is a variable rate based on West Penn's actual production costs at designated generating facilities. The capacity credit is a fixed rate of 4.0 cents per kwh based on a 1995 in-service date of an avoided 300 MW coal plant, and is slightly lower than West Penn's estimate as of September 1986 of the levelized present value of avoided capacity over the life of the project.

The agreements governing all three projects provide that West Penn will retain a mortgage and security interest in all real and tangible personal property of the projects, and a security interest in all intangible personal property of the projects, subject only to the liens, charges and encumbrances securing the projects' debt or otherwise approved by West Penn.

WEST PENN'S PETITION

West Penn avers that its voluntary entrance into the three transactions was made "in complete reliance on its well-founded belief that doing so is in furtherance of federal laws and policy and of the laws and public policy of the Commonwealth of Pennsylvania, and that such actions will not in and of themselves now or in the future create circumstances which result in the imposition of penalties, restrictions or other adverse circumstances on West Penn and its investors and ratepayers." Petitions of West Penn, pp. 7, 5-6, and 6, respectively. West Penn also avers that the capacity credits to be paid to the Monongahela, Burgettstown and Shannopin Mine Projects are less than the capacity credits that may have been calculated under the Commission's own regulations implementing PURPA 210 at 52 Pa. Code §§ 57.31 *et seq.* Petitions of West Penn at pp. 4.

Conditions precedent to West Penn's obligations under the power purchase agreements are final Commission Orders satisfactory to West Penn allowing West Penn a full and timely pass through to its ratepayers of all charges paid by West Penn under the agreements. West Penn also requests that the Commission provide for a public notice and comment period regarding such rate treatment for due process reasons and to foreclose possible future collateral attacks on the Commission's Orders. West Penn states that it will not voluntarily enter into the three power purchase agreements absent such public notice and comment period. Finally, although not part of the formal relief requested by West Penn, West Penn submits that, in view of the excess capacity provisions of Section 1323 of the Public Utility Code, 66 Pa. C.S. § 1323, the Commission's Orders should encompass a finding that the entrance by West Penn into the power purchase agreements does not result in excess capacity under Section 1323 as to the capacity of the projects themselves or as to any *existing* West Penn capacity.

RESPONSIVE PLEADINGS TO WEST PENN'S PETITION

Several pleadings in response to West Penn's petitions have been filed with the Commission. On January 20, 1988 the Office of Consumer Advocate ("OCA") filed an Answer to West Penn's petition pertaining to the Monongahela Project. OCA takes no position at this time regarding the avoided cost calculation which forms the basis for the proposed power purchase agreement and rate treatment. OCA objects to "any contract approval which contains the type of excess capacity protective language sought by West Penn in Paragraph 14 of its Petition." OCA Answer, p. 2. OCA notes that all but one of West Penn's prior contracts with qualifying facilities have been approved without this protective language as have the contracts of all of the other utilities in the Commonwealth.

OCA notes that the only prior Commission Order granting this relief, *Petition of West Penn Power Company Re Milesburg Energy, Inc.*, P-870216 (September 22, 1987), was appealed by OCA to the Commonwealth Court, the Petition for Review pending at No. 2418 C.D. 1987. OCA therefore urges that the Commission *not* grant the protective language regarding an excess capacity determination under Section 1323 of the Public Utility Code, 66 Pa. C.S. § 1323.

On January 25, 1988 OCA filed an Answer to West Penn's petition pertaining to the Burgettstown Project. In addition to a request that the Commission not include any protective language regarding Section 1323 in its Order, OCA submits that the Commission should not approve the contract until West Penn has demonstrated, through hearings, the propriety of the capacity credits to be paid under the power purchase agreement with the developer of the Burgettstown Project. In support of its request for hearings, OCA notes that West Penn's petition does not indicate what supply and demand forecasts were used by West Penn in connection with the Burgettstown Project. OCA's concern in this case is "to ensure that West Penn has not overstated its need for capacity and thus agreed to excessive capacity payments.' OCA Answer, p. 4. In particular, OCA questions West Penn's projections of a need (now avoided) for a new coal plant in the fourth quarter of 1995.

On Febraury 3, 1988 OCA filed an Answer to West Penn's petition pertaining to the Shannopin Mine Project that essentially is identical to its Answer to West Penn's petition pertaining to the Burgettstown Project. OCA also requests that the two proceedings be consolidated for hearings in view of the identity of issues and in the interest of administrative economy.

On January 20, January 21, and February 3, 1988 Airco Industrial Gases ("Airco") filed Petitions to Intervene in the Monongahela, Burgettstown, and Shannopin

Mine proceedings respectively. Airco avers that it is a large, energy intensive industrial customer of West Penn, and that it has a vital interest in the Commission's determination of the issues in these proceedings. Airco did not file an Answer to any of the West Penn petitions.

On January 26, January 25, and February 8, 1988 Armco, Inc. and Allegheny Ludlum Corporation ("Armco/Allegheny") filed Petitions to Intervene in the Monongahela, Burgettstown, and Shannopin Mine proceedings, respectively. Armco/Allegheny aver that they are large manufacturers and processors of steel products and ratepayers of West Penn, and that they have a vital interest in the Commission's determination of the issues in these proceedings. Armco/Allegheny did *not* file an Answer to West Penn's petition pertaining to the Monongahela Project. Armco/Allegheny did, however, file Answers to West Penn's petitions pertaining to the Burgettstown and Shannopin Mine Projects. Armco/Allegheny aver, *inter alia*, that the capacity credits to be paid for energy produced by the Burgettstown and Shannopin Mine Projects are excessive, essentially because in Armco/Allegheny's opinion West Penn does not need the capacity of a coal plant in 1995. Armco/Allegheny's averment is based on a perception that West Penn underestimated its generation supply and overestimated its reserve margin in projecting a need for a 1995 coal plant. In particular, Armco/Allegheny refer to a recent five-year contract between Allegheny Power System ("APS") and the Old Dominion Electric Cooperative ("ODEC") for the sale of 300 MW of capacity, the existence of the Springdale and Mitchell units in cold reserve, and the availability of power from the Ohio Valley Electric Cooperative as support for their averments concerning generation supply. With regard to West Penn's reserve margin, Armco/Allegheny aver that West Penn based its calculation of the capacity credits offered to the Burgettstown and Shannopin Mine Projects on a 25-31% margin, which Armco/Allegheny aver should be

lower "because West Penn's generating units have become more reliable in recent years." Answers, pp. 8 and 10, respectively. Finally, Armco/Allegheny aver some legal conclusions concerning the calculation of capacity credits, the payment of capacity credits prior to the in-service date of avoided capacity, the applicability to the projects of Section 1323 of the Public Utility Code, 66 Pa. C.S. § 1323, the requirement that the Commission hold a hearing on West Penn's petitions, and the Commission's previous "determination" at P-870216 that the proposed addition of 43 MW from the Milesburg Project would fully satisfy West Penn's capacity needs. Armco/Allegheny request that the Burgettstown and Shannopin Mine Projects be considered together.

On January 26, 1988 North Branch Energy Partners, L.P. ("North Branch"), the developer of the Burgettstown Project, filed a Petition to Intervene in the proceeding at P-880284 and Statement in Support of West Penn's petition. North Branch avers, *inter alia*, that the use of bituminous refuse by the Burgettstown Project will solve an environmental problem that has long plagued industry and the Commonwealth, will conserve depletable fuels, and will produce carbon dioxide that can be used by other industrial concerns. Approximately 200-300 jobs will be created during the construction period and approximately 50 persons will be employed on a permanent basis. North Branch further avers that the rates established by the power purchase agreement are just and reasonable, will not exceed the present value of West Penn's avoided costs over the term of the agreement, and are less than those that would be required by the Commission's regulations implementing PURPA 210 at 52 Pa. Code §§ 57.31 *et seq*. North Branch cites prior Commission decisions for the propositions that a QF is entitled to a known stream of payments based on the utility's avoided costs, even if the costs avoided would not occur until sometime in the future, and that the avoided costs that are utilized are

those projected as of the date the QF offers to accept capacity credits based on the construction costs of a plant to which the utility is committed. Finally, North Branch joins in West Penn's request for a public comment period although it avers it needs prompt action on West Penn's petition to finance and construct the plant.

On February 9, 1988 Mon Valley Energy Corporation ("Mon Valley"), the developer of the Shannopin Mine Project, filed a Petition to Intervene in the proceeding at Docket No. P-880286. Mon Valley avers, *inter alia,* that the Shannopin Mine Project will use approximately 250,000 tons per year of high sulphur coal mined in the Commonwealth, that approximately 450 jobs will be created in the 24-30 month construction period, that 50-60 persons will be employed permanently to operate the facility, and that Shannopin Mining Company will need to employ approximately 20 additional persons in order to supply coal to the facility. On February 19, 1988 Mon Valley filed a Statement in Support of West Penn's Petition. Mon Valley avers that the rates to be paid for power produced by the Shannopin Mine Project are just and reasonable because the rates do not exceed the present value of West Penn's avoided costs over the term of the agreement, and the capacity credits are lower than those that might have been calculated under the Commission's regulations. Mon Valley further avers that it has assumed all risk associated with construction and operation of the Project, and that West Penn's interest in the Project is protected by various terms to the agreement. Mon Valley avers that the Project will be environmentally beneficial because in excess of 90% of the sulphur oxide emissions will be removed through advanced pollution control technology, and because low combustion temperatures will minimize the formation of nitrous oxides. Finally, Mon Valley avers that the cogenerated steam will be sold to Shannopin Mining Company for the purpose of drying coal, thereby improving the coal's quality and making Shannopin's future

coal sales more competitive with foreign and out-of-state coal.

In addition to formal pleadings in the form of Petitions to Intervene and Answers to West Penn's petitions, several governmental agencies and private entities have filed letters with the Commission expressing their views concerning the various projects. On January 21, 1988 the Western Pennsylvania Conservancy filed a letter in support of the Burgettstown Project. The Conservancy states that it is the largest private land conservation organization in Pennsylvania, with the purpose of conserving water, land and wildlife. The Conservancy believes the Burgettstown Project will convert waste land, with ongoing pollution problems, into a clean, economically productive use. In particular, the Conservancy states that the Project's site is the former Consolidation Coal Company's Champion 518 acre coal waste facility that was operated for over 40 years and that consists of pits and valleys filled with waste from deep and strip coal mines. Today the present owner, Bologna Coal Company, operates several treatment ponds that handle extensive acid mine drainage from the waste piles. The Conservancy states that erosion is severe, that high winds create choking dust from loose coal particles, and that aesthetically the site looks like the underside of the moon. The Conservancy notes that the technology to be utilized by the Project controls SO_2 and NO_x emissions without expensive and sometimes unreliable flue gas desulpherization equipment; that the Project meets all EPA and DER ambient air quality standards; that most of the waste water will be recycled; that sludges and solids will be disposed of in an approved aerated sewage package system; and that the end result of the project is reclaimed land capable of attracting industrial and commercial development.

On February 1, 1988 the Executive Director of the Redevelopment Authority of Washington County ("Authority") filed a letter in support of the Burgettstown Proj-

ect. The Authority urges the Commission's favorable action on the Project, noting that the Robinson Township area in Washington County is very economically distressed and is in great need of jobs and private investment. The Authority states that the Burgettstown Project represents an investment of $150 million, 200-300 construction jobs, 50-60 full-time permanent jobs, the reclamation of approximately 1,000 acres through the utilization of approximately 38 million tons of bituminous coal waste, and a very favorable potential for future development at the project's site at the intersection of U.S. Route 22 and State Route 980.

On February 1, 1988 the Group for Recycling in Pennsylvania, Inc. ("GRIP"), a nonprofit citizen group dedicated to the conservation of nautral resources and energy, filed a letter endorsing the Burgettstown Project for its creative and environmentally sound approach to cogeneration. GRIP avers that the operation of the Burgettstown Project will reduce the impact of acid run off and particulate dispersion by eliminating gob piles and slurry ponds, thereby enhancing the quality of the environment. GRIP requests the Commission's full consideration of West Penn's petition at P-880284.

On February 22, 1988 Northwest Economic and Employment Development, Inc. ("NEED"), a non-profit regional economic development corporation, filed a letter in support of the Burgettstown Project. NEED avers that the Burgettstown Project is absolutely essential to the future well-being and development of northwest Washington County for various reasons. In particular, NEED avers that (1) West Penn Water Company has proposed a badly needed regional water system for Northwest Washington County, the economic feasibility of which depends upon the construction of the Burgettstown Project; (2) the area's future economic development depends on the development of a public water system, the catalyst for which would be the Burgettstown Project; (3) the Project will create approximately 200 construction jobs and 50-60

permanent jobs in an area of high unemployment; (4) the Project would consume huge unsightly gob piles at the site and in their place create usable land for development at a prime location on an interchange of the Route 22 corridor; and (5) useful, low-cost electricity will be created from the waste and ravages of the past, thus creating value where there is none, and conserving other valuable resources.

On February 22, 1988 the Cross Creek Valley Regional Planning Commission filed a letter in support of the Burgettstown Project. The Commission states that the plan of the Western Pennsylvania Water Co. to supply water to the northern portion of Washington County is contingent upon the development of the Burgettstown Project; that the Project will provide many badly needed jobs in the area; and that utilization of the gob pile for fuel will remove an eyesore and be environmentally helpful.

On February 25, 1988 the Robinson Township Board of Supervisors filed a letter in support of the Burgettstown Project. The Board of Supervisors states that the Project will transform a vast wasteland of coal refuse, lagoons and ravines left over from coal mining into an area that can be developed for commercial or industrial uses in a prime location at Route 980 and U.S. Route 22; that the Project's creation of over 200 construction jobs and 50-60 permanent jobs could be the seed that will provide growth and development in the township; and that the area is in need of public water and sewage systems, which would accompany the construction of the Project.

On February 25, 1988 the Board of Commissioners of Washington County filed a letter in support of the Burgettstown Project. The Board of Commissioners states that the Project is compatible with the goals of economic development, environmental improvement, resource conservation, and future land use for economic development.

In particular, the Commissioners refer to the creation of approximately 200 construction jobs and 50-60 permanent jobs; the extension of public water service to several thousand persons; the utilization of unsightly gob piles; and the region's economic decline, lost population, high unemployment and decreasing property values.

On February 29, 1988 the Supervisors of Smith Township, Washington County, filed a letter in support of the Burgettstown Project. The Supervisors state that due to the high unemployment in the area the Project would be a welcome uplift, and that eliminating the unsightly gob piles to produce good usable land, low cost electricity, and steam for future use would be a great asset.

On March 1, 1988 the Board of Supervisors of Hanover Township, Washington County filed a letter in support of the Burgettstown Project. The Board states that the Project would provide construction jobs as well as full-time jobs upon completion; would play an important role in revitalization of the area; would eliminate a long-standing environmental problem in the area; and would reclaim land capable of attracting industrial and commercial development in neighboring Robinson Township.

On May 9, 1988 the Dunkard Township Supervisors filed a letter in support of the Shannopin Mine Project. The Supervisors state that the Project will help secure the jobs of 225 Shannopin Mining Company employees, will employ 450 persons during construction, and upon completion will employ 50 permanent employees and provide new business for local suppliers. The Supervisors state that the Project will provide a much needed increase in tax revenues for Dunkard Township.

On May 9, 1988 the Board of Commissioners of Greene County filed a letter in support of the Shannopin Mine Project. The Board of Commissioners states that the Project will help secure the jobs of the current Shannopin Mining Company employees, will generate new

jobs, and will use the best technology for burning coal, which will reduce emissions below federal and state standards. It is the Board's hope that the technology will be forerunner of future fossil fuel power plants in Pennsylvania that will assure the coal industry of a long term market.

On May 10, May 12 and 27, 1988, respectively, Lee Supply Co. Inc., Local 6159 of the United Mineworkers of America and Sandvik Rock Tools, Inc. filed letters in support of the Shannopin Project. All three letters express support based on the same considerations expressed by the Greene County Board of Commissioners.

On May 16, 1988 the Greene County Association of Township Supervisors filed a letter stating that the Association had unanimously passed a resolution endorsing the Shannopin Mine Project. The Association states that the Project will help secure the jobs of 225 Shannopin Mining Company employees, will employ 450 persons during construction, and upon completion will employ 50 permanent employees and provide new business for local suppliers. The Association notes that Greene County has the highest unemployment rate in the state.

REPLIES TO THE RESPONSIVE PLEADINGS:

West Penn filed replies to OCA's Answers to the Petitions governing the Monongahela, Burgettstown and Shannopin Projects on February 11, February 16, and February 26, 1988, respectively. West Penn's Reply to OCA's Answer to the Monongahela Petition denies that the requested § 1323 protective language was not included in all but one of the Commission's Orders approving prior power purchase agreements between West Penn and various QFs. With respect to the Commission's Orders at P-840563 and C-844022, West Penn avers that the § 1323 protective language was unnecessary because the Commission's Orders predated Act 114 of 1986, which added § 1323 to the Public Utility Code. With

respect to the Commission's Orders at P-860165 and P-840563 (approval of modification of previously-approved capacity and energy credits), it is West Penn's position "that while the Commission declined West Penn's request for positive answers . . . West Penn's questions concerning Section 1323, by approving the agreements the Commission implicity made a determination that the agreements were in accord with the Pennsylvania Public Utility Code, including Section 1323." Reply, p. 2. In response to OCA's averment that the Commission's Order at P-870216 went even further than West Penn's request (by excluding the Milesburg capacity from excess capacity determinations with respect to *any* generating units during the terms of the contract, as opposed to *existing* generating units), West Penn agrees that QF capacity should be taken into account with regard to the generation it is designed to delay or avoid. Reply, p. 3.

West Penn's Replies to OCA's Answers to the Burgettstown and Shannopin Petitions respond to OCA's concern that West Penn may have overstated its need for capacity by stating, *inter alia,* as follows:

> . . . West Penn submits that the pricing for the Milesburg Project [approved by the Commission by Order entered September 22, 1987 at Docket No. P-870216] was established by West Penn and Milesburg Energy, Inc. on May 8, 1986 and that the pricing between West Penn and North Branch Energy Partners, L.P., for the Burgettstown Project [and Mon Valley Energy Corporation for the Shannopin Mine Project] was established on October 6, 1986 [and September 10, 1986, respectively]. The Commission has recognized that for agreements under Section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA 210), pricing terms should be locked in as of the date the pricing is established. *See* Commission Order in Allegheny Lock and Dam #5 at Docket No. P-860165, en-

> tered January 7, 1987. At the time the pricing for the Milesburg Project [,] . . . the Burgettstown Project [, and the Shannopin Mine Project] were established the relevant portions of West Penn's generation plan were the same.
>
> The generation plan indicated that, for planning purposes, to avoid West Penn's reserve margin falling below the minimally acceptable 25% level, additional generating capacity would be needed in 1995. To accomplish this, a three-unit station, with each unit being 300 megawatts, was planned with the units coming in service in 1995, 1997 and 1998. Under the PURPA 210 agreements, . . . the Milesburg Project[,] . . . the Burgettstown Project [, and the Shannopin Mine Project] pricing were based upon avoiding a portion of the same station. Hence, the generation plan that supported [the] Milesburg Project also supports the Burgettstown Project [and the Shannopin Mine Project]. Although the decision is now on appeal, the Commission did approve the avoided capacity payments for the Milesburg Project. Further, at the time the Burgettstown Project [and the Shannopin Mine Project] pricing was established, the Commission had already approved, after adversary hearings, West Penn's planning capacity reserve margin at Docket No. R-842632 (Order entered August 28, 1985) and had originally affirmed the same at Docket No. R-850220 (Order entered July 25, 1986). Moreover, a methodology of utilizing future needed capacity as a basis for determining avoided capacity costs for PURPA 210 is included in the Commission's own regulations governing PURPA at 52 Pa. Code § 57.31, *et seq.*

West Penn's Replies to OCA's Answers, pp. 1-3. West Penn further avers that the combined effect of all planned PURPA 210 projects contributes to the delay of West Penn capacity, and that the issue of the appropriateness

of West Penn's reserve capacity margin at the time in question does not require a hearing since the issue had already been decided by the Commission at Docket Nos. R-842632 and R-850220. With respect to OCA's position on the relief requested by West Penn vis-a-vis Section 1323, West Penn's Replies reiterate its Reply to OCA's Answer to the Monongahela Petition, *supra.*

West Penn also filed Replies to the Answers to Armco/Allegheny to the Petitions governing the Burgettstown and Shannopin Projects on February 16 and March 2, 1988, respectively. West Penn, *inter alia,* states that Armco/Allegheny's comparison of the proposed QF agreements to the recent contract between APS and ODEC is neither revelant nor meaningful. The contract with ODEC is limited to a term not exceeding seven years, while the Burgettstown and Shannopin agreements are based, pursuant to PURPA 210, upon the present worth of future avoided or delayed capacity levelized over a period of 33 and 30 years, respectively. Moreover, West Penn submits that the avoided capacity costs for the Burgettstown and Shannopin Projects were based on a planned three-unit power station, the first unit of which was projected to come on line in 1995, at which time the ODEC transaction will be concluded. West Penn also denies Armco/Allegheny's allegation that the Burgettstown and Shannopin Projects represent non-firm capacity. Answers, pp. 3-5.

With respect to Armco/Allegheny's allegation that West Penn improperly failed to account for the 361 MW Springdale and Mitchell units in cold reserve, West Penn submits that Armco/Allegheny mistakenly assumed that West Penn's avoided cost calculations were based on the new coal-fired capacity being on-line prior to the reactivization of the Springdale and Mitchell units. West Penn avers that, under the generation plan in effect at the time price agreement with Burgettstown and Shannopin was reached, the Mitchell and Springdale units

were planned to come on-line in March 1992 and March 1993, prior to the avoided capacity on which the Burgettstown and Shannopin capacity payments are based. Although West Penn's current plans include reactivization of the units in 1998 and 1999, West Penn states that Armco/Allegheny fail to distinguish between the generation plan in effect at the time price agreement with the QFs was reached and the current generation plan. West Penn submits that "under its current generation planning, the Mitchell No. 1 and 2 and the Springdale units are planned to be reactivated in 1998 and 1999, and the plan does not include any new West Penn owned generating capacity until *after* Mitchell Nos. 1 and 2 and the Springdale units are reactivated." Replies of West Penn, pp. 6 (emphasis supplied). West Penn admits that the units can be made operational to provide *peaking* capacity.

With respect to Armco/Allegheny's allegation that the capacity credits to be paid for power produced by the Burgettstown and Shannopin Mine Projects are excessive because West Penn did not factor into its calculation the availability of power from the Ohio Valley Electric Cooperative ("OVEC"), West Penn states that, on the basis of official current projections by the federal Department of Energy ("DOE"), for planning purposes it must be assumed that no OVEC capacity will be available to West Penn after October 1988.[3]

With respect to Armco/Allegheny's allegation that the proposed capacity credits are excessive because they were

---

[3] West Penn is a sponsoring company of OVEC, which has generating stations with a net demonstrated capability of approximately 2,300 MW. OVEC supplies the power needs of DOE's gaseous diffusion plant located near Portsmouth Ohio, which produces fuel for domestic and foreign nuclear power plants. All OVEC generating capacity unneeded by DOE is made available to the sponsoring companies. West Penn's current cost of power from OVEC is about 1.7 cents per kwh for entitlement power and less for additional temporary power.

based on an excessive reserve margin of 25-31%, West Penn states that the 1995 in-service date of the first unit of the planned three-unit coal station, on which the capacity credits were based, was the date at which West Penn projected that its planning reserve magrin would fall below 25%. At the time the capacity credits were agreed upon, in September and October 1986, the Commission had approved West Penn's planning reserve margin at Docket No. R-842632, and had affirmed the same at Docket No. R-850220. West Penn admits that, in general, its generating unit availability has increased in recent years, but avers that the extent of long-term improvement to availability was not determined by September/October 1986, when the pricing agreements governing the Burgettstown and Shannopin Mine Projects were established. In response to Armco/Allegheny's averment that various parties to the proceeding on remand at Docket No. 850220 had argued for a reserve margin lower than 25%, West Penn states that this case was finalized by a Commission Order entered February 12, 1988 that adopted a settlement agreement among the parties to the proceeding, and that the Commission made no specific finding as to generating reserves.

With respect to Armco/Allegheny's legal argument concerning the levelization of capacity credits, and the applicability of Section 1323(a) to qualifying facilities, West Penn responds that the Commission's regulations at 52 Pa. Code § 57.31 *et seq.*, set forth a methodology of utilizing future capacity needs as a basis for determining capacity credits; that the timing differences between the in-service dates of the Projects and the avoided capacity is accounted for by West Penn's methodology for determining capacity credits; and that as to West Penn, purchases from qualifying facilities constitute purchased power. With respect to Armco/Allegheny's legal argument concerning due process requirements, West Penn responds that due process does not necesasrily require a full evidentiary hearing for approval of the instant Peti-

tions. Further it is West Penn's position that the reserve capacity margin issue was fully litigated by Armco/Allegheny at Docket Nos. R-842632 and R-850220 for the time period relevant to the instant proceedings, and that due process would not require a further full evidentiary hearing on this issue. With respect to Armco/Allegheny's reference to language in the Commission's Order approving the agreement between West Penn and Milesburg Energy, Inc. (wherein the Commission stated, *inter alia*, that additional QFs could be considered as excessive, and that future agreements would be closely scrutinized), West Penn avers that the pricing for the Milesburg, Burgettstown and Shannopin Mine Projects were based on the same generation plan, and that the pricing for all three projects were based upon avoiding a portion of the same generating unit, e.g., the first of three 300 MW coal units planned for 1995, 1997 and 1998. Hence, the generation plan that supported the Milesburg Project also supports the Burgettstown and Shannopin Mine Project pricing. Finally, West Penn states that, if the Commission elects to hold hearings in the instant proceedings, it would not object to Armco/Allegheny's request that the Projects be considered together. West Penn also incorporates by reference relevant portions of the transcript at Docket Nos. R-842632 and R-850220.

North Branch filed a Response to the Answer of Armco/Allegheny to West Penn's Petition pertaining to the Burgettstown Project on February 16, 1988. North Branch avers that, in 1984, Energy Management Associates ("EMA") conducted a Reserve Margin Study for West Penn that found that a prudent reserve margin for West Penn would be 25 to 37% over winter peak; that the study was the subject of a hearing before the Commission; that West Penn's witnesses who testified in support of the study were cross-examined by Armco/Allegheny; and that the Commission ultimately found that West Penn's "planning reserve range of 25 to 31% is reasonable." North Branch cites *Pa.P.U.C. v. West*

Penn Power Co., 69 PUR 4th 470 at 489 (1985). North Branch also avers that the Allegheny Power System Generation Capacity Plan dated October 1, 1985, which was filed with the Commission as part of West Penn's annual Capacity Planning Report on April 29, 1985, and which is attached as Exhibit 6 to North Branch's Response, showed a need to construct a new plant comprised of three 300 MW coal plants to meet demand by October 1995; and that in a proceeding in which West Penn presented testimony and Armco/Allegheny cross-examined witnesses, the Commission found that the 1985 Capacity Plan was reasonable. North Branch cites *Pa.P.U.C. v. West Penn Power Co.*, 77 PUR 4th 220 at 244 (1987). North Branch further avers that it began negotiations with West Penn in July 1985 and that the parties reached price agreement in October 1986 based on the 1984 Reserve Margin Study and the 1985 Capacity Plan. North Branch avers that it has expended in excess of $2.1 million in planning, design, engineering and legal fees to insure that the Project can be placed in-service by October, 1991. North Branch avers that the capacity credit of 3.6 cents per kwh is slightly less than West Penn's internal calculation of avoided cost, and 1.25 cents per kwh less than West Penn's avoided costs calculated in accordance with the Commission's regulations at 52 Pa. Code § 57.34(c). In addition to the arguments/averments made by West Penn, North Branch describes the proposed fluidized bed technology as commercially mature and points out that, if the technology were deficient, it would be North Branch that would bear the risk of nonperformance, as opposed to West Penn or its ratepayers. North Branch projects annual savings of over $7 million in 1991 dollars to West Penn's ratepayers attributable to the Burgettstown Project when compared to the payments that would be required pursuant to the Commission's regulations. With regard to Armco/Allegheny's assertion that the Burgettstown capacity is unneeded due to the "return" of West Penn's 135 MW share of the ODEC power by 1995, at the latest, North Branch

points out that the APS projections set forth in the 1985 Capacity Plan do not anticipate this load ever leaving the system, yet a need for new capacity was anticipated by October 1995. North Branch states that the Commission repeatedly has held that a qualifying facility is entitled to a known stream of payments based upon estimates of a utility's avoided costs as of the date the qualifying facility accepts capacity credits based on the construction costs of a plant to which the utility is committed, citing *AES Beaver Valley, Inc. v. West Penn Power Co.*, Docket No. C-844022 (Order entered October 10, 1986). With respect to Armco/Allegheny's averments concerning the Springdale and Mitchell units, North Branch notes that the 1985 Capacity Plan shows reactivation in 1992 and 1993, and that even with the then-projected reactivation, the Capacity Plan shows a need for new capacity in 1995. North Branch avers that the Springdale and Mitchell plants are old, peaking units and do not have 33 years of remaining life. "The ability of the cogeneration plant to come on-line in 1991 provides a benefit to West Penn's ratepayers by eliminating the need to reactivate old oil-fired units solely for peaking purposes which have a limited life and which burn a fuel whose costs are both high and extremely volatile. Instead, North Branch provides ratepayers with a reliable, efficient fixed-cost base load unit." North Branch Response, p. 18. With respect to Armco/Allegheny's arguments concerning OVEC capacity, North Branch avers that DOE has requested OVEC to submit to it a proposal to extend the existing DOE-OVEC agreement through 2005. North Branch attached as Exhibits 7 and 8 to their Response the APS-OVEC Power Agreement of July 27, 1987 and a "Message from the President" of OVEC dated April 15, 1987 stating *inter alia*, that DOE has made a request to extend the agreement through 2005. North Branch avers that it would be irresponsible for West Penn to assume for planning purposes that DOE will not take any further power from OVEC after 1992. With respect to Armco/Allegheny's

legal argument that a levelized capacity credit in general is improper, North Branch notes that both the Commission's and the Federal Energy Regulatory Commission's ("FERC") regulations implementing PURPA 210 sanction the levelization of rates paid to QFs. North Branch also notes that the capacity credit it will receive has been greatly reduced due to the timing difference between its anticipated 1991 on-line date and the 1995 projected need for capacity, and that if the facility were to come on-line in 1995, the capacity credit would be substantially higher, resulting in increased costs to ratepayers. With respect to Armco/Allegheny's legal arguments pertaining to the excess capacity provision found at Section 1323 of the Public Utility Code, 66 Pa. C.S. § 1323, North Branch responds that the Section 1323's definition of excess capacity is merely a rebuttable presumption, as opposed to an inflexible rule, and that Act 114 of 1986 contained several provisions in addition to Section 1323 designed to encourage qualifying facilities. North Branch also refers to the Commission's proposed policy statement on the treatment of qualifying facilities in excess capacity determinations, published at 17 *Pa.B.* 3035 (July 18, 1987, and the Commission's Order in *Petition of West Penn Power Co. Re Milesburg Energy, Inc.*, Docket No. R-870216 (September 22, 1987) as authority for the proposition that the capacity represented by the Burgettstown Project would not be included in an excess capacity determination with respect to West Penn's existing generating units. North Branch states that inclusion of capacity from qualifying facilities in excess capacity determinations with respect to existing utility units would in effect penalize the utility for complying with federal law, a result not permitted under the Supremacy Clause of the U.S. Constitution. In response to Armco/Allegheny's legal argument concerning due process, North Branch avers that the instant proceeding constitutes a rate decrease, as opposed to an increase, and that Armco/Allegheny have not cited any authority for the proposition that a due process right

to a hearing attaches when rates are decreased. North Branch asserts that the only variables at issue in calculating the appropriate capacity credit are the proper reserve margin and the date the avoided unit would be needed:

> With respect to these two issues [Armco/Allegheny] have been afforded two full hearings with the right to cross-examine witnesses and present witnesses of their own. They claim initially that the 1984 Reserve Margin Study of EMA is flawed. That study has been the subject of two proceedings before the Commission and has been found to be reasonable by the Commission. *See* 69 PUR 4th 470 at 489. Next [Armco/Allegheny] claim that the 1985 Capacity Plan is erroneous. That plan has also been approved by this Commission after a hearing in which [Armco/Allegheny] participated, cross-examined witnesses and presented rebuttal testimony. *See* 77 PUR 4th 220 at 244.
>
> Calculation of a proper capacity credit in this case is merely ministerial once a reserve study and a capacity generation plan have been validated and approved by the Commission. No other component of the calculation has been questioned by [Armco/Allegheny]. [Armco/Allegheny] are not really requesting a due process hearing but in fact are requesting a second or perhaps third bite at the apple since they were unsuccessful in the other proceedings.

North Branch Response, pp. 28-29. Finally, North Branch disputes Armco/Allegheny's reliance on dicta contained in the Commission's order approving the agreement between West Penn and Milesburg Energy, Inc. by stating that the computation of the capacity credits for the Milesburg and Burgettstown Projects were made on the same basis. North Branch avers that the 1985 Capacity Plan utilizes a yearly increase in demand forecasts of less than 2%, and that should demand increase at a greater rate, West Penn would require additional capacity prior to 1995.

North Branch also filed a Response to the Answer of OCA to West Penn's Petition pertaining to the Burgettstown Project on February 16, 1988. North Branch incorporates by reference paragraphs 1 through 14 of its Response to Armco/Allegheny's Answer. In addition, North Branch avers that OCA as well as Armco/Allegheny was a party to the proceedings in which the 1984 Energy Management Associates Reserve Margin Study and the 1985 Generation Capacity Plan were approved by the Commission. North Branch incorporates by reference relevant provisions from its Response to Armco/Allegheny regarding the dicta contained in the Commission's Milesburg Order; the appropriate planning reserves; the 1985 Capacity Plan; and the excess capacity protection sought by West Penn. In conclusion, North Branch asserts that OCA's request for further hearings on the 1984 Reserve Study and the 1985 Capacity Plan can be viewed only as an attempt to kill the Burgettstown and similar projects, and that OCA apparently would prefer subjecting ratepayers to the risks involved when utilities construct large power plants rather than allowing the risk of escalating costs to be shifted to private developers.

Mon Valley filed Responses to the Answers of Armco/Allegheny and OCA to West Penn's Petition pertaining to the Shannopin Mine Project on March 2 and February 25, 1988, respectively. Mon Valley disagrees with Armco/Allegheny's statement that the circulating fluidized bed boiler and related technology entails a high design risk. Mon Valley avers that the technology is commercially available from several manufacturers including Pyropower, Combustion Engineering, Riley Stoker, Babcock and Wilcox, and Keeler Dorr Oliver, and that a substantial number of units are in service. Mon Valley avers that the levelization of payments to developers of QFs is in compliance with PURPA and the Public Utility Code and that the excess capacity protective language sought by West Penn is consistent with the Commission's proposed policy state-

ment on the issue and with Act 114 of 1986. Finally, Mon Valley concurs with OCA and Armco/Allegheny's request to consolidate the proceedings pertaining to the Burgettstown and Shannopin Mine Projects. In addition, Mon Valley requests that the proceeding involving the Monongahela Lock and Dam No. 8 Project be consolidated as well since all three proceedings involve common questions of law and fact.

The final responsive pleading filed in the three above-captioned proceedings is Armco/Allegheny's Reply to the Response of North Branch to Armco/Allegheny's Answer to West Penn's Petition pertaining to the Burgettstown Project, filed on March 10, 1988. Generally, Armco/Allegheny state that the rationale underlying North Branch's Response ignores the current realities on the West Penn system. Utilizing various sources of information, Armco/Allegheny aver that West Penn currently has more than sufficient capacity to satisfy its customers' requirements, and that the excess capacity situation will not be alleviated in the near future. Essentially, Armco/Allegheny dispute the proposition that the reasonableness of capacity credits are to be based upon estimates of a utility's avoided costs as of the date the qualifying facility accepts capacity credits based upon the construction costs of a plant to which the utility is committed. Armco/Allegheny's position is that all events that occur between the date of price agreement and the date of the Commission's decision must be considered when evaluating the agreement. Armco/Allegheny aver that North Branch contradicts itself by referring to West Penn's Exhibit 2, which is the utility's analysis of the Value of Generating Capacity to be provided by the Burgettstown Project, and which is dated December 8, 1987. Other than this legal argument, the balance of Armco/Allegheny's pleading is essentially a restatement of its factual assertions regarding the ODEC sale, and the existence of the Springdale and Mitchell Units. Two factual assertions raised for the first time are,

first, a reference to an APS Analysis of Generating Units prepared in November 1982 (attached as Exhibit 8 to Armco/Allegheny's Reply) that concludes, *inter alia*, that there is an economic incentive to pursue the conversion of the 207 MW Springdale unit to coal. Armco/Allegheny argue that West Penn's avoided costs should be based on the Springdale unit, as opposed to a new 300 coal unit. The second factual assertion raised for the first time is a reference to a document under protective order at Docket No. R-850220 (the Bath County Reconsideration). Armco/Allegheny state that the document casts doubt upon certain assertions made by North Branch and West Penn, and that West Penn has refused to allow the document into the record of the instant proceeding.

WEST PENN'S MOTION FOR A PROTECTIVE ORDER

On March 24, 1988 West Penn filed a Motion for a Protective Order in the proceeding pertaining to the Burgettstown Project at Docket No. P-880284. West Penn avers that, in the hearings at Docket R-850220 (Bath County reconsideration) ALJ Klovekorn issued an order on September 15, 1987 sealing a certain document marked as Armco/Allegheny Ludlum Cross Examination Exhibit No. 1. ALJ Klovekorn's bench order was as follows:

> Hearing the discussion of the parties, I agree with the Company that Armco-Allegheny Ludlum Cross Examination Exhibit No. 1 contains proprietary information which had best be kept under seal and separate from the other documents in this proceeding.
>
> I will direct the court reporter to seal this document, and I would direct the parties that if they refer to this material in their brief, that it shall be done in a special proprietary brief separate and apart from the public brief in this matter. And I'll direct the parties

> —I will remind the parties that in view of the proprietary nature of this exhibit it should not be disseminated to persons or organizations other than parties to this proceeding.

N.T. at 1513, Docket No. R-850220.

In addition to sealing the document, ALJ Klovekorn also sealed the cross-examination testimony relating to the document at N.T. pp. 1538 through 1547.

West Penn avers that Armco/Allegheny's attorney contacted West Penn several days prior to March 10, 1988 and sought permission to disclose certain information set forth in the sealed exhibit, which West Penn refused. West Penn avers that Armco/Allegheny's Reply to the Response of North Branch ("Reply"), filed March 10, 1988, disclosed some of the confidential information. West Penn requests that the Commission enter an Order striking Armco/Allegheny's Reply, requiring that the original and all copies of the Reply be returned to the Commission to be destroyed, and prohibiting any further disclosure of the information set forth in certain paragraphs of the Reply.

On March 31, 1988 Armco/Allegheny filed a Memorandum in Opposition to West Penn's Motion for a Protective Order. Armco/Allegheny aver that its Reply was worded carefully so as not to reveal any proprietary information, and that no specific factual information was disclosed at all.

DISCUSSION

1. *Analysis of Proposed Capacity Credits.*

As a preliminary matter, we will grant the Petitions to Intervene as filed by Airco, Armco/Allegheny, North Branch and Mon Valley. All of these entities have an interest in the proceedings that is not adequately represented by any other party. See 52 Pa. Code § 5.72.

Because West Penn's Petitions and the various pleadings filed in response thereto raise common issues of fact and law, we have determined that it would be more efficient to consider the proceedings together rather than separately. Therefore, we will consolidate the three proceedings for the purpose of discussion and disposition.

The three projects that are the subject of the instant proceeding are qualifying facilities ("QFs") under Section 201 of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), Act Nov. 9, 1978, P.L. 95-617, Title II, § 201, 92 Stat. 3134, codified at 16 U.S.C. § 796 (17) through (22). Pursuant to Section 210 of PURPA, codified at 16 U.S.C. § 824a-3, West Penn is required by law to purchase the power produced by the three projects at a price equal to West Penn's full avoided costs as defined by PURPA and the regulations thereunder at 18 C.F.R. § 292.304(b)(2) and 52 Pa. Code § 57.34. The U.S. Supreme Court upheld the full avoided cost rule in 1983. *American Paper Institute v. American Electric Power Service,* 461 U.S. 402 (1983).

In addition to our regulation setting forth the methodology for the calculation of a utility's full avoided costs, *supra.*, our regulations provide that utilities and QFs are free to negotiate contracts that provide for the payment of rates below those that otherwise would be required. 52 Pa. Code § 57.32(c). Consistent with our past practice, we will grant West Penn's requests for rate recovery approval if the agreements with the developers of the Monongahela, Burgettstown and Shannopin Mine Projects provide for rates that are at or below West Penn's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31 *et seq.* If the proposed rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically are recoverable from ratepayers.[4]

---

[4] *See Petition of Pennsylvania Electric Company Re Scrubgrass Power Corp.,* Docket No. P-870248 (January 21, 1988) for a dis-

Therefore, the only factual issue to be resolved in the instant proceeding is whether the proposed rates are at or below West Penn's full avoided costs as defined by PURPA 210 and the regulations thereunder.

West Penn's Exhibits 2 to its three Petitions set forth the calculation of the capacity credits to be paid for power purchased from the Monongahela, Burgettstown and Shannopin Mine Projects. Exhibit 2 to the Petition pertaining to the Monongahela Projects identifies mid-1985 as the "date of decision," or price agreement. The date that additional capacity is needed (coal plant start date) is identified as the latter part of 1992. Exhibit 2 to the Petition pertaining to the Burgettstown Project identifies the date of decision as October 6, 1986 and the date that additional capacity is needed (coal plant start date) as the latter part of 1995. Exhibit 2 to the Petition pertaining to the Shannopin Mine Project identifies the date of decision as September 10, 1986 and the coal plant start date as the latter part of 1995.

Although there are many extraneous issues raised by the various pleadings in these proceedings, the heart of the matter really is whether West Penn's projection of a need for capacity at the time that the three agreements were being negotiated was reasonable. If so, the payment of a capacity credit to the various developers is required by law.

It is well settled that the time period that controls evaluation of projections of avoided costs is the time during which negotiations between the utility and the QF occur. *See* Preamble to 18 C.F.R. § 292.101 *et seq.*, 45 *Fed. Reg.* 12224 (February 25, 1980); 52 Pa. Code § 57.34(c)(1); *Petition of West Penn Power Company Re Allegheny Lock and Dam No. 6,* Docket No. P-840563 (January 7, 1987); *AES Beaver Valley Inc. v. West Penn Power Company,* Docket No. C-844022 (October 10, 1986). As demonstrated by West Penn's Ex-

---

cussion of the Commission's policy regarding rate recovery of amounts paid for power generated by QFs.

hibits 2, *supra*, price agreement with the developers of the Burgettstown and Shannopin Mine Projects was reached in October and September, 1986, respectively. The negotiated capacity credits were based on a need projected at that time for additional capacity in 1995. Therefore, with respect to the Burgettstown and Shannopin Mine Projects, the question before the Commission is whether West Penn's 1986 projected need for capacity in 1995 was reasonable during the period of contract negotiations in 1986. With respect to the Monongahela Project, the question is whether West Penn's projected need for capacity in 1992 was reasonable during the period of contract negotiations prior to the price agreement of April 1985.

Pursuant to 52 Pa. Code § 57.33, all electric utilities in Pennsylvania are required to file system cost data on an annual basis in order "[t]o make available data from which energy or energy and capacity credits may be derived." 52 Pa. Code § 57.33(b)(1). These filings, commonly referred to as "avoided cost filings" include information concerning the utility's plans for the addition of plant during the current and each of the next ten (10) years. 52 Pa. Code § 57.33(b)(1)(ii) and (iii). West Penn's plans for the addition of three (3) 300 MW future coal plants have been incorporated into West Penn's avoided cost filings since at least July 1984, or during all relevant periods in question. West Penn's avoided cost filing of July 31, 1984 identified the addition of the coal units in 1992, 1994 and 1996. The in-service dates of the coal units have been steadily deferred, in part due to the inclusion of QF capacity in West Penn's capacity plans. Thus, West Penn's July 1985 avoided cost filing identified the in-service dates as 1992, 1994 and 1997. West Penn's July 1986 avoided cost filing identified the in-service dates as 1995, 1997 and 1998.[5]

---

[5] West Penn's most recent avoided cost filing of July 1987, which is not relevant to the instant proceeding, identifies the in-service dates as 2000, 2001 and 2004.

During the period following the effective date of our regulations implementing PURPA 210, or since January 10, 1983, the Commission has approved four (4) agreements between West Penn and the developers of four qualifying facilities in the following proceedings:

1. *Petition of West Penn Power Re AES Beaver Valley,* Docket No. P-844022 (January 24, 1985 and October 10, 1986) (115 MW cogeneration facility).

2. *Petition of West Penn Power Re Allegheny Lock and Dam No. 6,* Docket No. P-840563 (April 19, 1985 and January 7, 1987) (9 MW small power production facility).

3. *Petition of West Penn Power Re Allegheny Lock and Dam No. 5,* Docket No. P-860165 (January 7, 1987) (8 MW small power production facility).

4. *Petition of West Penn Power Re Milesburg Energy, Inc.,* Docket No. P-870216 (September 22, 1987).

All four agreements approved by the Commission provided for the payment of a capacity credit based upon West Penn's projected need for the series of three (3) 300 MW coal units at some point in the future. The capacity credit of 3.4 cents (later modified to adjust for inflation) to be paid to AES Beaver Valley was based on the 1992 coal plant (negotiated in 1984)[6], the capacity credit of 3.6 cents to be paid to Allegheny Lock and Dam No. 6 was based on the 1992 coal plant (negotiated in 1984)[7]; the capacity credit of 3.5 cents to be paid to Al-

---

[6] See Exhibit 2 to West Penn's Petition filed September 4, 1984.

[7] See West Penn's Petition filed October 15, 1986 at p. 5 and Exhibit 6 thereto.

legheny Lock and Dam No. 5 was based on the 1992 coal plant [8] (negotiated in 1984); and the capacity credit of 3.3 cents to be paid to Milesburg Energy Inc. was based on the 1995 coal plant [9] (negotiated in 1986). Thus, the Commission routinely has approved West Penn agreements providing for the payment of capacity credits based on the three (3) future 300 MW coal units. In the instant proceedings, the capacity credit of 3.6 cents proposed to be paid for power produced by the Monongahela Project was negotiated in early 1985 and was based on the 1992 coal plant; and the capacity credits of 3.6 cents and 4.0 cents proposed to be paid to the Burgettstown and Shannopin Mine Projects, respectively, were negotiated in 1986 and were based on the 1995 coal plant. The proposed capacity credits therefore are based on the same capacity addition plans upon which the previously-approved credits were based, *supra*. Although the Commission's prior sanction, in effect, of West Penn's capacity addition plans as a proper basis for the calculation of capacity credits may not be conclusive, it weighs heavily in favor of the granting of West Penn's Petitions in the instant proceeding. In particular, the capacity credits proposed to be paid to the Burgettstown and Shannopin Mine Projects were negotiated during the same period and were based upon the same capacity addition plans as the previously-approved capacity credits to be paid to Milesburg Energy, Inc. The capacity credit proposed to be paid to the Monongahela Project was based on the same capacity addition plan as the previously-approved capacity credits to be paid to the AES Beaver Valley, Allegheny Lock and Dam No. 6 and Allegheny Lock and Dam No. 5 Projects, *supra*.

---

[8] See West Penn's Petition filed October 15, 1986 and Exhibit 2 thereto.

[9] See West Penn's Petition filed April 2, 1987 and Exhibit 2 thereto.

As West Penn notes in its Replies to OCA's Answers to the Petitions pertaining to the Burgettstown and Shannopin Mine Projects, West Penn's 1986 capacity addition plan, which indicated a need for additional capacity in 1995, was based on a reserve margin of 25%. As noted by West Penn, the Commission approved West Penn's planning capacity reserve margin of 25% by Orders entered on August 28, 1985 and July 25, 1986 at Docket Nos. R-842632 and R-850220, respectively. Both of these Orders were entered after full evidentiary hearings in the context of general rate increase proceedings addressing, generally, the Bath County Pumped Storage Unit. OCA, Airco, and Armco/Allegheny were parties to the proceeding at R-850220, *Pa. P.U.C. et al. v. West Penn Power.*[10] In that proceeding, we found, in relevant part, as follows:

> In the prior rate proceeding at Docket No. 842632, we first determined that the Company's reserve margin, with a range of 25%-31% and an optimum of 28%, was reasonable. We then set forth the reserve margins as shown in Column A above . . . [West Penn's Annual Capacity Planning Report filed April 29, 1986] presents a similar pattern, except that there is a one year lag. Thus, the coming winter, 1986-87, is considerably above the 25%-31% range. Within two years, however, it reaches the top of that range, 31% in the winter of 1988-89, and in one more year, it reaches the optimum, 28% in the winter of 1989-90.
>
> In short, essentially the same forecasts and planning which we found reasonable in the prior proceeding are again before us in the instant proceeding, and we again find them reasonable.

---

[10] Airco participated as a member of the West Penn Power Industrial Intervenors ("WPPII"); Armco/Allegheny participated jointly under the designation of the Large Power Industrial Intervenors ("LII").

Pa. P.U.C. et al. v. West Penn Power, Docket No. R-850220 (July 25, 1986) at pp. 42-44.[11]

That fact that we have on two prior occasions found, after fully litigated proceedings, that the optimum reserves margin for West Penn is 28%, with a range of 25 to 31%, adds further support to West Penn's capacity addition plans upon which the capacity credits in the instant proceeding were based. As stated above, West Penn's projected need for the future three (3) 300 MW coal units was based on a planning reserve of 25%, which is *lower* than the optimum of 28% as determined by the Commission, and at the lowest end of the range of 25% to 31% that was found to be reasonable.

Under our regulations, the payment of a capacity credit is required if a utility is forecasted to need additional capacity within a ten-year period. 52 Pa. Code § 57.34(c)(4)(iii). Utilizing West Penn's Annual Capacity Planning Report filed on April 29, 1986 pursuant to 52 Pa. Code § 57.49 ("1986 I.D. 138 filing"),[12] the following reserve margins can be projected by utilizing the projections of operable resources and peak demand:

---

[11] By Order entered April 17, 1987, we granted WPPII's Petition to Reopen Record and granted in part the petitions for reconsideration filed by WPPII and OCA in light of 66 Pa. C.S. § 1323(a). On January 12, 1988 the various parties filed a Settlement Agreement with the Administrative Law Judge ("ALJ"). The ALJ's Recommended Decision to approve the Settlement Agreement was adopted by the Commission by Order entered February 12, 1988. Pursuant to the settlement, all parties agreed to dismiss, withdraw and discontinue with prejudice all proceedings relating to the legality or propriety of the inclusion of Bath County costs in rates.

[12] In the Bath County rate proceeding at Docket No. R-850220, *supra,* the Commission took official notice of the 1986 I.D. 138 filing. Opinion and Order, p. 41. WPPII supported the Trial Staff's motion for official notice. West Penn has incorporated relevant portions of the transcript at R-850220 into the record of the instant proceeding.

Year	Operable Resources (MW)*	Peak Demand (MW)	Reserve Margin (%)**
1986/87	3780	2720	28.04
1987/88	3709	2776	25.16
1988/89	3687	2821	23.49
1989/90	3685	2869	22.14
1990/91	3680	2912	20.87
1991/92	3776	2961	19.45
1992/93	3744	3004	19.76
1993/94	3835	3043	20.65
1994/95	3830	3084	19.48
1995/96	3962	3121	21.23

* Net Capability + Scheduled Imports—Scheduled Exports—Inoperable Capability

** Does not include Scheduled Outages

Source: Form 138-B.

Utilizing the previously determined reserve margin of 25%-31% and the reserve margins projected by West Penn during the period in question demonstrates that West Penn was projected to need additional capacity in 1995.[13] Therefore, the payment of capacity credits to QFs would be required pursuant to the Commission's regulations. Generally, West Penn's methodology for calculating capacity credits results in a more conservative (lower) credit than would result from the application of the methodology set forth in our regulations. Consequently, the negotiated capacity credits proposed to be paid to the Burgettstown and Shannopin Mine Projects are lower than those that would be required by law absent the voluntary agreements under consideration. Because the proposed rates are lower than those that could have been required, the rates are *per se* reasonable and automatically are recoverable from ratepayers. Therefore, it would appear that West Penn's petitions for rate recovery approval must be granted.

---

[13] In fact, it would appear that, in 1986, West Penn was projecting a need for additional capacity by 1988/89. Although it is not necessary to make this determination in the instant proceeding, such a determination would support the payment of full, rather than discounted, capacity credits to Burgettstown and Shannopin.

Turning now to the various pleadings filed in response to West Penn's petitions, we will address the various issues pertaining to the appropriateness of the credits in the following paragraphs.

First, with respect to OCA's and Armco/Allegheny's request for evidentiary hearings, we note that the projected need for capacity depends in large part upon the determination of a utility's appropriate reserve margin. That determination having been made, as discussed above, we see no reason for further evidentiary hearings in order relitigate the issue. Moreover, if we were to require an evidentiary hearing in all proceedings involving utility-QF agreements, we are concerned that the time and expense involved would severely hamper the continued development of cost effective cogeneration and small power production in the Commonwealth. A simple reference to the saga of the proceedings addressing the Bath County Project, which addressed a plant that was *completed* and the issue of West Penn's appropriate reserve margins and the reserve margins projected in the near future, is an indication of the potential complexity of a proceeding involving a utility-QF agreement, which could involve projections of reserve margins up to ten years into the future. Unlike a utility, a QF typically is project-financed, which means that a project typically will not be able to bear the expense and time involved in what essentially could be a complex rate proceeding.

FERC recognized the dangers of requiring evidentiary hearings on a case-by-case basis at the federal level in an analogous situation. On the issue of whether FERC's interconnect rules should require QFs to go through the complex procedures set forth in the Federal Power Act, FERC found that:

> [T]o require qualifying facilities to go through the complex procedures set forth in . . . the Federal Power Act to gain interconnection would, in most circumstances, significantly frustrate the achievement

> of the benefits of this program. . . . The Commission believes that accomplishment of this purpose [of providing a market for QFs] would be greatly hindered if it were to require qualifying facilities to utilize . . . the Federal Power Act as the exclusive means of obtaining interconnection. It therefore concludes that such a restrictive interpretation of the laws is not supportable.

45 *Fed. Reg.* 12222 (February 25, 1980). FERC's final regulations therefore required electric utilities to make interconnections to qualifying facilities upon request. 18 C.F.R. § 292.303(c). In reviewing and approving FERC's interconnect rule, the U.S. Supreme Court stated as follows:

> The purposes of [PURPA 210] make it most unlikely that Congress could have intended that an evidentiary hearing be held for every interconnection necessary to consummate a purchase or sale of electricity authorized by the Act. Evidentiary hearings under . . . the FPA entail a determination of whether a proposed interconnection (1) is in the public interest, and (2) would encourage overall conservation of energy or capital, optimize the efficiency of use of facilities and resources, or improve the reliability of the affected utility systems. It is highly doubtful that Congress could have intended that the Commission make such a determination every time a qualifying facility seeks to hook up with a utility to complete a purchase or sale under PURPA. . . .
>
> *Providing an opportunity for evidentiary hearings before the Commission for every interconnection necessary to complete a purchase or sale under PURPA would seriously impede the very development of cogeneration and small power production that Congress sought to facilitate.* Many of the facilities in question are small operations. By definition a small power production facility has a produc-

> tion capacity of no more than 80 megawatts, and cogeneration facilities may also be of modest size. Many owners of qualifying facilities would have little incentive to purchase or sell electric energy if they had to go through an evidentiary hearing before FERC in Washington, D.C., every time they needed to hook up with a utility to consummate a purchase or sale. . . . If we were to hold that utilities must be provided an opportunity for a hearing whenever a qualifying facility seeks an interconnection in order to effectuate a purchase or sale under PURPA, we would be 'imput[ing] to Congress a purpose to paralyze with one hand what it sought to promote with the other.

American Paper Institute v. American Electric Power Service Corp., 461 U.S. 402, 419-421 (1983) (citations omitted) (emphasis supplied).

Although we may, where necessary and appropriate, exercise our discretion in specific proceedings involving utility-QF agreements and order evidentiary proceedings, there is no requirement in administrative proceedings that the opportunity to be heard take place before an administrative law judge. "The essential requirements of due process . . . are notice and an opportunity to respond. The opportunity to present reasons, either in person *or in writing*, why proposed action should not be taken is a fundamental due process requirement." *Cleveland Board of Education v. Loudermill*, 470 U.S. 532 (1985) (emphasis supplied). The U.S. Supreme Court in *Loudermill* cited Friendly, "Some Kind of Hearing," 123 U. Pa. L. Rev. 1267 (1975) for the proposition that something less than a full evidentiary hearing is sufficient due process prior to administrative actions. *See: Northwestern Indiana Telephone Co. v. Federal Communications Commission*, 824 F.2d 1205 (D.C. Cir. 1987).

In the instant proceeding, we are considering proposed payments to three QFs that are mandated by law. West

Penn does not have the discretion to refuse to purchase the output of the Monongahela, Burgettstown and Shannopin Mine Projects. The only factual issue involved is whether or not the proposed payments are at or below West Penn's avoided costs as defined by law. In view of the fact that (1) West Penn's plans for the addition of three (3) 300 MW coal plants have been included in all of West Penn's avoided cost filings during 1984-1986; (2) West Penn's generation plans formed the basis for four previously-approved agreements with QFs; and (2) the appropriate reserve margin for West Penn has been established during the relevant time period after full adversarial hearing, we decline to exercise our discretion to order an evidentiary hearing.[14]

Armco/Allegheny raised several specific issues regarding West Penn's capacity situation. With respect to the five-year contract between Allegheny Power System ("APS") and the Old Dominion Electric Cooperative ("ODEC") for the sale of 300 MW of capacity, we agree with West Penn that a comparison of the proposed QF agreements to the APS/ODEC contract is neither relevant nor meaningful. The contract with ODEC is limited to a term not exceeding seven years, while the pricing agreements with the QFs are based, pursuant to PURPA 210, upon the present worth of future avoided or delayed capacity. Moreover, the pricing under the APS/ODEC agreement was based primarily on embedded costs, which are irrelevant to a determination of the capacity credits to be paid to a qualifying facility. FERC addressed this point by stating that "[t]he utility's avoided incremental costs (and not average system costs) should

---

[14] **Armco/Allegheny's reference to dicta at pp. 6-7 of our Order approving the West Penn-Milesburg agreement is misplaced. This dicta, which stated that agreements filed by West Penn subsequent to the agreement with Milesburg would be scrutinized closely by the Commission, does not constitute a finding on any issue, and certainly does not constitute a determination that the addition of Milesburg would fully satisfy West Penn's capacity needs.**

be used to calculate avoided costs. With regard to capacity, if a purchase from a qualifying facility permits the utility to avoid the addition of new capacity, then *the avoided cost of new capacity and not the average embeded system cost of capacity should be used.*" 45 *Fed. Reg.* 12216 (February 25, 1980) (emphasis supplied). Therefore, Armco/Allegheny's argument on this point has no merit and is rejected. With respect to Armco/Allegheny's averments concerning the Springdale and Mitchell units in cold reserve, we note that, under the generation plan in effect at the time price agreement with Burgettstown and Shannopin was reached, the Mitchell and Springdale units were planned to come on-line in March 1992 and March 1993, prior to the avoided capacity upon which the proposed capacity credits were based. We agree with West Penn that Armco/Allegheny fail to distinguish between the generation plan in effect at the time price agreement was reached and the current generation plan. As previously discussed, the generation plan in effect at the time of price negotiations or agreement is controlling. Moreover, we note that the Springdale and Mitchell units can be made operational to provide *peaking* capacity, while the three QFs under consideration are designed to defer or avoid needed baseload capacity. Therefore, a comparison of the proposed capacity credits to the costs of reactivating the Springdale and Mitchell units is inappropriate. With respect to Armco/Allegheny's averment that West Penn's previously determined appropriate reserve margin should be lowered "because West Penn's generating units have become more reliable in recent years," we note that, as discussed extensively above, the generation plan in effect at the time of price negotiations or agreement is controlling and the Commission previously determined in 1985 and 1986 that a reserve margin of 25% to 31% was appropriate. We decline to reopen this issue to consider events that may have occurred since 1985 and 1986. With respect to Armco/Allegheny's averments that West Penn should

have in essence, relied upon the possibility that power from the Ohio Valley Electric Cooperative would be available in the future to West Penn, we reject the notion that a utility should rely upon chance for capacity planning purposes. West Penn's obligation to serve would not permit it to rely upon mere speculation when planning its future capacity additions or purchases. West Penn states that, on the basis of official current projections by DOE, for planning purposes it must be assumed that no OVEC capacity will be available to West Penn after October 1988.

2. *Rate levelization.*

Armco/Allegheny again have objected to levelization of rates generally. This issue was raised in the proceeding involving Milesburg Energy, Inc. and rejected by our Order of September 22, 1987. Essentially, Armco/Allegheny's objection is based upon timing differences between West Penn's projected need for capacity and the projected on-line date of the QFs. This argument is very similar to the "ratepayer avoided cost" and "utility avoided cost" argument that we consistently have rejected since 1985. *AES Beaver Valley v. West Penn Power,* Docket No. C-844022 (March 13, 1985); *Petition of West Penn Power Re Allegheny Lock and Dam No. 5,* Docket No. P-860165 (January 7, 1987) at pp. 7-8; *Petition of West Penn Power Re Allegheny Lock and Dam No. 6,* Docket No. P-840563 (January 7, 1987) at p. 5.

Neither FERC's nor this Commission's regulations implementing PURPA 210 require a matching of rates to avoided costs at the time of delivery. FERC's regulations specifically provide that " '[i]n the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subject if the rates for such purchases differ from avoided costs at the time of delivery." 18 C.F.R.

§ 292.304(b)(5). *See* 45 *Fed. Reg.* 12224 (February 25, 1980). In fact, when we promulgated our regulations at 52 Pa. Code § 57.31 *et seq.*, we specifically rejected a suggestion for a capacity credit methodology that would have tracked the declining revenue requirement that would be associated with a utility-owned base load unit under traditional regulation. *Implementation of the Public Utility Regulatory Policies Act of 1978*, Docket No. L-810060 (1982), as published at 12 *Pa.B.* 4239 (December 11, 1982). Levelization of capacity credits in fact contributes to solving the intergenerational inequity problem under traditional regulation, where the revenue requirement associated with a new utility unit is highest in the early years of operation when the plant is likely to be needed least.

Our regulations, as well as West Penn's internal methodology, fully account for timing differences by discounting the capacity credit to be paid to a QF when that QF is expected on-line prior to the time that a utility is projected to need capacity. In simpler terms, the proposed capacity credits have been lowered to account for the timing difference between the QFs' anticipated on-line dates and the 1995 coal plant.

This issue having been addressed on many prior occasions, we reject Armco/Allegheny's argument.

3. *Section 1323 of the Pennsylvania Public Utility Code, 66 Pa. C.S. § 1323.*

West Penn has requested protective language finding that the entrance by West Penn into the proposed power purchase agreements will not result in excess capacity under Section 1323 as to the capacity of the projects themselves or as to any existing West Penn capacity. OCA has requested that the Commission not include the requested finding in any order it may issue. Armco/Allegheny argue that QF capacity itself is subject to a Section

1323(a) analysis, and that West Penn has asked for a declaration that "if the company builds a new generating facility any time within the next 30 years, the Commission will ignore the capacity from the Shannopin project when determining whether the new West Penn plant is needed." Armco/Allegheny's Answer, p. 14.

As a preliminary matter, we note that Armco/Allegheny have mistinterpreted the scope of the relief sought by West Penn. West Penn essentially has asked only that it not be penalized with regard to its *existing* units by virtue of its agreement to purchase power produced by the Monongahela, Burgettstown and Shannopin Mine Projects. It has not, as averred by Armco/Allegheny, requested that the QF capacity be excluded from a Section 1323(a) excess capacity analysis of units that West Penn may be build in the *future*. This clarification aside, the Section 1323 issue was raised and fully addressed in the Commission's Order approving the rates proposed to be paid to Milesburg Energy, Inc., *supra*. In the Milesburg proceeding, we followed our proposed policy statement on the treatment of qualifying facilities in excess capacity determinations that was published at 17 *Pa.B.* 3035 (July 18, 1987). Our Order in the Milesburg stated as follows:

> Consistent with the Commission's current thinking as expressed in the proposed "Policy Statement on the Treatment of Qualifying Facilities in Excess Capacity Determinations" . . . it is proper that the relief requested by West Penn be granted. In the proposed statement of policy, the Commission held that in most cases it is both appropriate and consistent with the legislative intent to exclude QF capacity in excess capacity/reserve calculations pursuant to Section 1323 —the exception being where a utility purchases long-term QF capacity and subsequently fails to defer or cancel planned construction of its own generation.

Opinion and Order, p. 6. Our holding therefore excluded the QF capacity from an excess capacity determination for

West Penn's existing capacity. The holding would permit inclusion of QF capacity in excess capacity determinations for future West Penn capacity additions. From a policy perspective, this result is sound because it requires West Penn to consider QF capacity in its capacity addition plans. From a legal perspective, we interpret Section 1323 as permitting the result reached by our proposed policy statement and applied in the Milesburg proceeding. Section 1323(c) provides that, in some specific instances, the Commission is precluded from considering QFs in determining the reasonable reserve margin and economic benefits associated with a new utility-owned base load generating unit. This provision expressly prohibits the Commission from exercising its otherwise flexible limit of judgment in matters concerning ratemaking in specific situations. In cases not governed by Section 1323(c), we have retained our flexibility to consider QFS in a manner based on our sound judgment on areas of ratemaking. In fact, the limited Section 1323(c) exemption, which pertains only to older utility plant placed in service prior to July 1985, already is largely irrelevant. There are no electric base load units placed in service prior to July 1985 that have not already been scrutinized by the Commission in a base rate proceeding. West Penn's Bath County Project, which was under consideration at the time the instant petitions were filed, reached commercial operation in December 1985. The 1323(a) analysis of Bath County has been resolved by a settlement agreement approved by a Commission Order of February 12, 1988 at R-850220.

In addition to the specific exemption governing pre-July 1985 utility plants, Section 1323(c) also preserves the Commission's pre-existing authority, which permits the Commission to weigh all factors in an appropriate manner in determining whether a utility's plant meets the used and useful criteria in an excess capacity analysis.

In addition to their arguments concerning Section 1323 (c) and the inclusion of QF capacity in a capacity de-

termination with respect to utility-owned plant, Armco/Allegheny also argue that QF capacity itself triggers a Section 1323(a) excess capacity analysis. We disagree. Our interpretation of Section 1323(a) is that it applies only to utility-owned generating units. The disallowances set forth therein simply do not apply to power purchase agreements, such as the ones at hand, where the utility recovers its expenditures on a dollar for dollar basis. West Penn acts merely as a conduit for the collection of amounts paid to qualifying facilities, and does not earn a return or a profit on any aspect of its power purchase agreements. Thus, the disallowances set forth in Section 1323(a), which require a disallowance of a return *on* excess capacity or the equity investment in a unit, have no applicability to purchases of power from QFs. The Commission's additional authority under 1323(a) to "disallow any other costs of the unit or units which the Commission deems appropriate" should not be read as applicable to rates required under PURPA 210. Because utility/QF agreements nearly always provide for the levelization of rates, as *required* by our regulations, it would be extremely difficult for many QF projects designed to provide long-term cost savings to the utility and its consumers to meet the reasonable reserve margin and net economic benefits tests set forth in Section 1323 (a) if these tests were strictly applied and limited to a relatively short-term horizon for analysis purposes. Thus, an interpretation of Section 1323(a) as applicable to power purchases from QFs would, in effect, prohibit rate levelization, a result clearly not intended by the Legislature in the enactment of Act 114 of 1986. Moreover, rates paid to QFs are governed by federal law, as opposed to state statutes governing retail electric rates. The test year concept is used in the traditional rate setting process by which a utility's base rates are determined, and has no applicability to costs paid pursuant to PURPA 210. As discussed above, rate levelization specifically is authorized by federal law. Therefore, we reject Armco/Allegheny's proposed interpretation of Section 1323(a)

as applicable to power purchase agreements between utilities and qualifying facilities.

Since we previously have found that the relief requested by West Penn is appropriate, we grant West Penn's request and find that the Monongahela, Burgettstown and Shannopin Mine capacity will not result in an excess capacity determination with respect to the capacity of the projects themselves or as to any existing West Penn capacity.

4. *West Penn's request to publish the Order for comment in the Pennsylvania Bulletin.*

Consistent with its prior practice, West Penn has requested that we issue a tentative opinion and order in these proceedings and publish it for comment in the Pennsylvania Bulletin. Our decision regarding this request is within our discretion, as there is no legal requirement or entitlement to have an order published for comment in the Pennsylvania Bulletin. We in fact rarely publish orders unless the order sets a new precedent on a legal issue of some interest to the public at large, which is not the case in the instant proceeding. No other utility in Pennsylvania requests the relief requested by West Penn. In the past, we have twice granted West Penn's request for publication (AES Beaver Valley and Allegheny Lock and Dam No. 6) and three times denied the request (Milesburg Energy, Allegheny Lock and Dam No. 5 and modification to Allegheny Lock and Dam No. 6).

In the instant proceedings, we will exercise our discretion by granting, in part, West Penn's request. Rather than publication of this lengthy order, we will direct publication of a notice that a tentative opinion and order in these proceedings has been adopted and is available upon request from West Penn. Absent the filing of any exceptions, the tentative opinion and order will become final within thirty (30) days of the publication of the notice.

Although we will exercise our discretion by granting West Penn's request, in part, in the instant proceeding, we caution West Penn that our decision does not guarantee relief of the type requested in future proceedings. Should West Penn in the future file a similar petition or petitions, West Penn is advised to contact the Commission's staff to discuss a method that would satisfy West Penn's concerns by providing the notice perceived necessary by West Penn at the time its initial pleading is filed.

5. *West Penn's Motion for a Protective Order.*

Upon review of the document under seal, we are of the opinion that the exhibit does not reveal anything of relevance to the proceeding under review. The exhibit is merely an APS internal memorandum with an attached computer printout containing certain information on all QF projects on the APS "active negotiations list . . . which are not the projects in the integrated resource plan." N.T. 1513. According to Armco/Allegheny, reference to this exhibit would demonstrate, *inter alia*, that price agreement between West Penn and North Branch was not reached in October 1986.

Our review of the computer printout reveals that the information set forth therein is not completely accurate. For example, the status of the contract with the Allegheny Lock and Dam Nos. 5 and 6 projects is not accurate as of the date of the printout. We have no reason to question West Penn's sworn statement that price agreement was reached in October 1986. Moreover, the date that controls evaluations of avoided costs is the time period during which active negotiations take place, as opposed to the time firm price agreement is reached. This provision is designed to protect QFs from the loss of entitlement to particular rates in the event that a utility "stonewalls" on acceptance of a price offer. Therefore, there is no need to have this exhibit admitted to the record in this proceeding.

With respect to West Penn's request that we strike Armco/Allegheny's Reply and require that all copies of the Reply be returned to the Commission for destruction, we agree with Armco/Allegheny that no specific factual information was revealed in the Reply. Therefore, we will deny West Penn's request for the above-stated relief, but note that the exhibit continues to be subject to the protective order issued by ALJ Klovekorn. Because the document does not contain any information of relevance in the instant proceeding, we will prohibit any future references to the document however carefully they may be worded.

Consistent with our prior orders in similar proceedings, we decline to review the non-price terms of the proposed agreements; THEREFORE,

IT IS ORDERED:

1. That the Petitions to Intervene filed by Airco Industrial Gases ("Airco"), Armco, Inc. and Allegheny Ludlum Corporation ("Armco/Allegheny"), North Branch Energy Partners, L.P. ("North Branch"), and Mon Valley Energy Corporation ("Mon Valley") are granted.

2. That the rates established by the proposed power purchase agreements between West Penn Power Company ("West Penn") and the developers of the Monongahela, Burgettstown and Shannopin Mine Projects are approved as just, reasonable and in the public interest.

3. That West Penn is authorized to fully collect all costs paid pursuant to the power purchase agreements through the Energy Cost Rate, or such mechanism as may replace the Energy Cost Rate in the future.

4. That the capacity represented by the Monongahela, Burgettstown and Shannopin Mine Projects does not represent excess capacity as to the capacity itself, and does not result in excess capacity as to any existing West Penn capacity.

5. That West Penn's Motion for a Protective Order is denied to the extent consistent with the Order.

6. That a copy of this Tentative Opinion and Order be served upon West Penn, Airco, Armco/Allegheny, North Branch, Mon Valley and the Office of Consumer Advocate.

7. That the Law Bureau prepare a notice for publication in the *Pennsylvania Bulletin* stating that the Commission has adopted the tentative opinion and order of today's date; that copies of the tentative opinion and order may be obtained from West Penn; and that the tentative opinion and order shall become final absent the filing of exceptions thereto within thirty (30) days of the publication of the notice.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: July 8, 1988

ORDER ENTERED: July 8, 1988

APPENDIX I

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held September 29, 1988

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice Chairman
Linda C. Taliaferro
Joseph Rhodes, Jr.
Frank Fischl,
dissenting in part

Docket Nos. P-880283, P880284, P-880286

PETITIONS OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS

RE: MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

ORDER

BY THE COMMISSION:

Before us are the above-captioned petitions by West Penn Power Company ("West Penn") requesting approval of amounts to be paid pursuant to power purchase agreements with the developers of the Monongahela Lock & Dam No. 8 Project ("Monongahela Project"), the Burgettstown Project, and the Shannopin Mine Project. By tentative Opinion and Order entered July 8, 1988 we

found, *inter alia,* that the rates established by the proposed power purchase agreements were just, reasonable, and in the public interest, and authorized West Penn to fully collect all costs paid pursuant to the power purchase agreements from ratepayers. Our Tentative Opinion and Order was published in the *Pennsylvania Bulletin* for Comment at 18 *Pa.B.* 3397 (July 30, 1988).

Timely Exceptions to our Tentative Opinion and Order have been received from Mr. F. Alan Sever, the West Penn Power Industrial Intervenors ("WPPII"),[1] the Office of Consumer Advocate ("OCA"), West Penn, and Armco, Inc. and Allegheny Ludlum Steel Corp. (collectively "Armco/Allegheny"). West Penn in turn filed Replies to the Excepitons of WPPII, OCA and Armco/Allegheny. Although our Tentative Opinion and Order by its own terms was to become final if no Exceptions were filed, the filing of the above-referenced Exceptions has prevented this from occurring. Consequently, West Penn's Petitions, the Tentative Opinion and Order and the Exceptions thereto are before us for further consideration.

DISCUSSION

Subsequent to the issuance of our Tentative Opinion and Order, the Commonwealth Court of Pennsylvania ("Commonwealth Court") on August 22, 1988 issued an Opinion and Order in a proceeding involving three consolidated appeals from our Order at *Petition of West Penn Power Company Re Milesburg Energy, Inc.,* Docket No. P-870216 (September 22, 1987). That Order approved rate recovery of amounts proposed to be paid under a power purchase agreement between West Penn and Milesburg Energy, Inc. ("MEI"), and granted West Penn's request for protective language under Section 1323 of the Public Utility Code, 66 Pa. C.S. § 1323. The Common-

[1] In these proceedings, the WPPII group is comprised of Airco Industrial Gases, Latrobe Steel Co., PPG Industries, Inc. and Powder Metal Products, Inc.

wealth Court's Opinion and Order [2] vacated the Commission's Order of September 22, 1987 and remanded the matter to us to reconsider our declaration that the capacity credit proposed to be paid to MEI was in the public interest, and our declaration that we will not consider the capacity represented by the Milesburg Project in future West Penn excess capacity determinations. In particular, the Commonwealth Court concluded that the capacity credit proposed to be paid to MEI involved substantial property interests of West Penn's ratepayers, and that these interests, in combination with the adjudicatory nature of the Commission's September 22, 1987 Order, required that ratepayers must be afforded due process. Slip Opinion at 21-22. In an analysis of what process is due, the Court held that, since payments for capacity were involved, the Commission should require West Penn to provide notice to its customers "in a manner consistent with that prescribed in 52 Pa. Code § 53.45(a), allowing for bill inserts in lieu of mailed or hand delivered individual notices." Slip Opinion at 29. With regard to the opportunity to be heard, the Court held that "the [C]ommission must devise a procedure that provides the *essential elements of a hearing*, but allows for consideration of petitions of the type involved here *in as expeditious and minimally burdensome a manner as possible*." Slip Opinion at 27 (emphasis supplied).

Although the Commission filed a Petition for Reargument of the Commonwealth Court's decision on September 6, 1988, we find it advisable in the instant proceedings to adhere to the procedural requirements imposed upon us by the Commonwealth Court's Opinion and Order. Failure to do so could subject the Commission's final Order in these proceedings to additional challenges, which would needlessly delay finalization of the proceedings

---

[2] *David M. Barasch et al. v. Pennsylvania Public Utility Commission*, Nos. 2418, 2499 and 2522 C.D. 1987 (filed August 22, 1988).

further. Accordingly, we will direct West Penn to notify its customers of the filing of the above-referenced petitions by bill insert, and will assign the proceedings to the Commission's Office of Administrative Law Judge ("OALJ") for hearing and recommended decision. The bill inserts should notify customers, at a minimum, of the general nature and docket numbers of the proceedings, the amount of the capacity credits on a per kwh basis, the general methodology by which the energy credits will be determined, the size in MW of the projects, the expected in-service dates of the projects, and the steps necessary to file a formal complaint with the Commission.

In so ordering, we have two observations. First, we note that the Commonwealth Court has *not* imposed upon the Commission a requirement that petitions of the type involved here be subjected to an exhaustive proceeding in the nature of a general rate increase proceeding under Section 1308(d) of the Public Utility Code, 66 Pa.C.S. § 1308(d). Accordingly, we will direct the OALJ to limit the scope of discovery, the admission of testimony and evidence; and the cross-examination of testimony to issues that are relevant to our consideration of West Penn's petitions. In our view, the fundamental factual issue to be resolved is whether the proposed rates are at or below West Penn's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31 *et seq.* If the rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically are recoverable from ratepayers. As we stated in our Tentative Opinion and Order, "the heart of the matter really is whether West Penn's projection of a need for capacity at the time that the three agreements were being negotiated was reasonable. If so, the payment of a capacity credit to the various developers is required by law." Tentative Opinion and Order at 22-23. An examination of this ultimate factual issue to be resolved will include an examination

of several sub-issues of fact, including but not limited to projections of West Penn's installed capacity and customer demand. With respect to the appropriate reserve margin for West Penn, our Tentative Opinion and Order relied upon the two prior litigated Bath County proceedings at Docket Nos. R-842632 and R-850220 where we found the optimum reserve margin for West Penn was 28 percent. West Penn's projected need for capacity in the instant proceedings was based on a *lower* planning reserve margin of 25%. OCA's Exceptions to the Tentative Opinion and Order argue, *inter alia*, that the doctrine of collateral estoppel should not be applied to our prior findings on West Penn's appropriate reserve margins. We will leave the issue of whether collateral estoppel is properly applicable to our prior findings to the ALJ for his/her consideration and recommendation.

To continue with our observations regarding the proper scope of the proceeding, we note that the Commission evaluates a utility's avoided costs as of the time negotiations between the utility and developer take place. Although we recognize that projections of avoided costs may decline over time, the opposite phenomenon also may occur. In order to prevent avoided cost rates from evolving into a constantly moving target, and to prevent utilities from depriving qualifying facilities ("QFs") of avoided cost rate entitlement by delaying negotiations, we consistently have evaluated avoided costs by reference to the time period during which serious negotiations take place. The procedural requirements imposed upon us by the Commonwealth Court have not affected the methodology by which this Commission calculates avoided costs. Nevertheless, Armco/Allegheny's Exceptions to the Tentative Opinion and Order argue that, *as a matter of law*, the agreements must be evaluated with reference to West Penn's current avoided costs. We reject this argument. FERC's preamble to its regulations states, *inter alia*, that "[u]se of the term 'legally enforceable obligation' is in-

tended to prevent a utility from circumventing the requirement that provides capacity credit for an eligible qualifying facility merely by refusing to enter into a contract with the qualifying facility." *Small Power Production and Cogeneration Facilities; Regulations Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978,* Docket No. RM79-55, Order No. 69 (February 19, 1980) as published at 45 *Fed. Reg.* 12214, 12224 (February 25, 1980). FERC further stated that the import of its regulations "is to ensure that a qualifying facility which has obtained the certainty of an arrangement, is not deprived of the benefits of its commitment as a result of changed circumstances." *Id.* Therefore, we reject Armco/Allegheny's argument that, as a matter of law, the agreements under review must be evaluated against West Penn's current avoided costs. Nevertheless, Armco/Allegheny may wish to argue that, as a matter of policy, the Commission should change the time frame against which avoided costs are evaluated. We do not wish to foreclose arguments for or against changes in Commission policy, although we note that our policy has worked well by providing a uniform framework against which agreements are evaluated in a consistent manner. Therefore, we leave the issue of whether or not to consider arguments for a change in policy to the ALJ's discretion, with a cautionary note that any such policy change advocated by Armco/Allegheny or other parties would have major impact on this Commission's implementation of Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3 ("PURPA 210"). Finally, we note that the Commonwealth Court affirmed the Commission's practice of approving agreements that provide for levelized payments, including the payment of capacity credits prior to the date that a utility projects a need for capacity. Slip Opinion at 33-38. Consequently, the ALJ should exclude this issue of timing and the "inter-generational" inequity argument from the scope of the proceeding to the extent that these arguments have been addressed and decided by the Commonwealth Court.

A second observation is that, as a practical matter, it would be preferable to consolidate the Milesburg proceeding at Docket No. P-870216 with the instant proceedings, and to consider all four proposed power purchase agreements together. The Milesburg, Burgettstown and Shannopin Mine Projects are based on the same generation plan, which projected a need for capacity in 1995. The common factual issues to these proceedings should be addressed together to minimize the expense to all of the parties involved, as well as to serve administrative economy. However, we do not, as of the date of this Order, have jurisdiction over the Milesburg proceeding. Rule 2572(a)(2) of the Pennsylvania Rules of Appellate Procedure provides that an application for reargument or a petition for allowance of appeal from the order "shall stay the remand of the record until the disposition thereof, and until 30 days after the entry of a final order in the appellate court possessed of the record." Pa.R.A.P. 2572(a)(2). In accordance with this provision, the earliest that we will regain jurisdiction over the Milesburg proceeding is thirty (30) days after our Petition for Reargument is acted upon by the Commonwealth Court. If the Commonwealth Court addresses the Petition for Reargument within a relatively short period of time, *and* no party (including the Commission) files a Petition for Allowance of Appeal with the Pennsylvania Supreme Court, the scheduling of the above-captioned proceedings may be able to accommodate consideration of West Penn's petition governing the Milesburg Project as well. Of course, we can not predict whether any party will Petition the Supreme Court for Allowance of Appeal, and in fact have not resolved this question on our own behalf. Nevertheless, we will request West Penn to include notice of the filing of the Milesburg petition in the bill insert required by the instant order so that we can consolidate all four proceedings if future events make that disposition possible.

As a final matter, we note that the Commonwealth Court's Opinion states that the Commission "should make

its own calculations of the maximum allowable capacity cost credit part of the record of the [Milesburg] proceeding, and it should provide access to its calculations to interested parties before the hearing." Slip Opinion at 27. In order to implement this directive in the instant proceedings, we will direct our advisory staff to calculate an estimated capacity credit to which the various developers would have been entitled under our regulations in the absence of a negotiated agreement, and to supply the calculaions to the ALJ and to the parties prior to the commencement of evidentiary hearings. Of course, these calculations will not be conclusive as to any issues to be decided in these proceedings, but will represent merely an application of the capacity credit formula set forth in our regulations at 52 Pa. Code § 57.34(c) to data on file at the Commission; THEREFORE,

IT IS ORDERED:

1. That West Penn Power Company ("West Penn") notify its customers of the filings of the above-captioned petitions by bill insert, to include at a minimum the information set forth above.

2. That the proceedings are consolidated for the purpose of hearing and assigned to the Office of Administrative Law Judge.

3. That a copy of this Order be served upon West Penn, the Office Consumer Advocate, Armco, Inc. and Allegheny Ludlum Steel Corp., the West Penn Power Industrial Intervenors, and Mr. F. Alan Sever.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 29, 1988

ORDER ENTERED: September 30, 1988

APPENDIX J

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held January 19, 1989

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice Chairman
Joseph Rhodes, Jr.
Frank Fischl

Docket Nos. P-870216 P-880283 P-880284 P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS

Re: MILESBURG ENERGY, INC.
MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

OPINION AND ORDER ON RECONSIDERATION

BY THE COMMISSION:

INTRODUCTION

On September 30, 1988, we entered an Order at Docket Nos. P-880283, P-880284, and P-880286 that, *inter alia*, consolidated those proceedings for the purpose of

hearing and assigned them to the Office of Administrative Law Judge ("OALJ"). On October 27, 1988, we entered an Order at these docket numbers that granted, pending further consideration of the merits, the variously-styled Petitions for Reconsideration that were filed by the West Penn Power Industrial Intervenors ("WPPII"), Armco, Inc. and Allegheny Ludlum Corporation ("Armco/Allegheny"), North Branch Energy Partners ("North Branch"), and West Penn Power Company ("West Penn").

Our order of today's date addresses the various Petitions for Reconsideration on the merits. In addition, it formally consolidates the proceeding at Docket P-870216, which pertains to Milesburg Energy, Inc., with the other three proceedings that we previously consolidated for the purpose of hearing.

BACKGROUND

Our September 30, 1988 Order was issued in response to *Barasch v. Pennsylvania Public Utility Commission*, —— Pa. Commonwealth Ct. ——, 546 A.2d 1296 (1988) ("*Milesburg*"). As we noted, the Commonwealth Court in that appeal vacated our order at Docket No. P-870216 of September 22, 1987 granting West Penn's Petition for rate recovery approval of amounts proposed to be paid to Milesburg Energy, Inc. ("MEI") and remanded the proceeding to the Commission. The Commonwealth Court concluded that the capacity credit proposed to be paid to MEI involved substantial property interests of West Penn's ratepayers, and that these interests, in combination with the adjudicatory nature of the Commission's September 22, 1987 Order, required that ratepayers be given notice of the filing of the petition and that "the [C]ommission must devise a procedure that provides the essential elements of a hearing, but allows for consideration of petitions of the type involved here in as

expeditious and minimally burdensome a manner as possible." 546 A.2d at 1307.

Pursuant to our September 30, 1988 Order, West Penn has provided notice of the filing of all four above-captioned petitions, including the petition governing its proposed power purchase agreement with MEI, by bill insert. Although we may not have had jurisdiction over the Milesburg proceeding on September 30, 1988 due to our Petition for Reargument of September 6, 1988 that was then pending before the Commonwealth Court, West Penn included notice of the MEI petition in its bill inserts pursuant to our request and in order to facilitate future consolidation of the MEI petition with the other three proceedings. Consequently, notice of the filing of all four petitions has been perfected.

On November 3, 1988, the Commonwealth Court filed an opinion and order in *Milesburg* granting in part and denying in part the Commission's Petition for Reargument. Relevant to the instant proceedings, the Commonwealth Court held that its August 22, 1988 decision "shall not have retroactive effect, but shall be applicable only to the petition for approval of the proposed contract in this case, between West Penn Power Company and Milesburg Energy, Inc., and to petitions filed with the PUC after August 22, 1988." Although West Penn's petitions governing Monongahela Lock and Dam No. 8 and the Burgettstown and Shannopin Mine Projects were filed *before* August 22, 1988, we will voluntarily apply the *Milesburg* requirements to these proceedings as contemplated by our September 30, 1988 Order. Our Petition for Reargument had requested only that prior Commission decisions approving rate recovery under PURPA 210 be, in essence, grandfathered under *Milesburg*.

On December 5, 1988, we filed a Petition for Allowance of Appeal of *Milesburg* with the Pennsylvania Supreme Court. The only aspect of *Milesburg* for which

we have sought review is the Commonwealth Court's prescription of the form of notice that the Commission must provide of rate recovery petitions similar to the one governing the proposed power purchase agreement between West Penn and MEI. Under the Pennsylvania Rules of Appellate Procedure, our Petition for Allowance of Appeal of this limited aspect of the Commonwealth Court's Opinion and Order does not prevent us from proceeding with the West Penn petition governing the proposed power purchase agreement with MEI. Pa. R.A.P. 1701(c). No other Petition for Allowance of Appeal of *Milesburg* having been filed,[1] our Order of today's date will formally consolidate all four docket numbers for the purpose of hearing.

DISCUSSION

The four variously-styled Petitions for Reconsideration will be discussed separately as set forth below.

West Penn filed a Petition for Reconsideration of our September 30, 1988 Order and a Request for Extraordinary Relief on October 17, 1988.[2] West Penn avers that it must have the proceeding concluded as quickly as possible in order to properly and orderly plan its generating capacity to serve the future needs of its ratepayers, and notes that the "litigation in these matters and in

---

[1] MEI filed a Cross-Petition for Allowance of Appeal on December, 19, 1988 which subsequently has been withdrawn.

[2] MEI filed an Answer supporting West Penn's Petition and Request on October 27, 1988. MEI avers that prompt resolution of the proceedings is critical to it due to the Financial Closing Date of February 28, 1989 for its project. OCA, WPPII and Armco/Allegheny jointly filed an Answer opposing West Penn's Request for Extraordinary Relief on October 26, 1988, generally opposing the procedural schedule proposed by West Penn. OCA also on October 26, 1988 filed a Response supporting West Penn's and related Petitions for Reconsideration to the extent the Petitions seek clarification that the September 30 Order does not contain any final determinations of contested issues.

the Milesburg case collectively involve more than 200 MW of generating capacity . . . and creates uncertainty as to whether West Penn will be able to rely on these projects to meet its future generation needs." Petition, p. 4. In order to expedite the hearing process, West Penn requests that the Commission itself, rather than the OALJ, preside over the hearings. This procedure would, according to West Penn, avoid the procedural delay occasioned by the time allowed for the filing of exceptions to the ALJ's recommended decision and the time necessary for the Commission to study the record in order to rule on the exceptions.

Although we are cognizant of the need to conclude these proceedings as quickly as possible, we will deny this request. It would not be practical to attempt to schedule evidentiary hearings before four Commissioners, all of whom have competing demands for their time and attention. Nevertheless, we will direct the OALJ to expedite the proceeding in any manner that is possible. Our September 30, 1988 Order implicitly conveyed as much by citing to the Commonwealth Court's directive to provide the "essential elements of a hearing" in a proceeding allowing for "consideration of the type involved here *in as expeditious and minimally burdensome a manner as possible.*" 546 A.2d at 1307 (emphasis supplied). Although we will not establish a firm deadline for the issuance of a recommended decision by the OALJ due to our inability to foresee all contingencies, we would request that a recommended decision be issued within two to three weeks after main briefs are filed, and suggest that the filing of reply briefs be eliminated. If hearings can be concluded by the end of February, this would permit the issuance of the recommended decision by the end of March.

West Penn also requests that the Commission provide for a trial type proceeding rather than a rate case type proceeding. By a trial type proceeding, West Penn means

a procedure whereby a mutual discovery period is followed by a continuous hearing at which all witnesses and all cross-examination are presented on a continuous basis. West Penn states that, in order to facilitate such a proceeding, liberal discovery should be allowed but a cutoff should be required before the hearings.

As we have decided that these proceedings should remain assigned to the OALJ, we shall refer consideration of this request to the ALJ assigned to the proceeding.

Finally, West Penn requests that the Commission indicate that the September 30, 1988 Order is not a final and appealable order, and that the final and appealable Order will not be rendered until the proceedings are concluded at the Commission. West Penn notes that granting this request would avoid the delay that could occur if the September 30 Order were appealed to the Commonwealth Court. West Penn suggests that the Commission order that all parties shall retain their rights to appeal any aspect of the September 30 Order until the conclusion of the appeal period following the entry, after hearing, of a final order on the merits. North Branch, the developer of the Burgettstown Project, similarly requests in its Motion for Reconsideration of October 17, 1988 that the Commission add an ordering paragraph to its September 30 Order stating that the Order is interlocutory in order to eliminate any appeals until the entry of a final order.

We will grant the requests of West Penn and North Branch and explicitly state what already is implicit, e.g., that the September 30 Order, as well as today's Order, are interlocutory only, and that all parties will have the opportunity to appeal any issue decided by the interlocutory orders at the conclusion of these proceedings.

WPPII filed a Petition for Reconsideration of the September 30 Order on October 14, 1988. WPPII objects to our directive to the OALJ to exclude the issue of the

appropriateness of levelization of rates paid to qualifying facilities from the scope of the proceeding. WPPII avers that, although the Commonwealth Court determined that levelized payments are consistent with Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3 ("PURPA"), the Court did not rule on the issue of whether the portion of the levelized payment which exceeds current avoided costs is recoverable from ratepayers on a current basis. WPPII requests that it be permitted to introduce testimony regarding a deferral mechanism that would delay recovery by West Penn of amounts paid to the qualifying facilities that exceed West Penn's current avoided costs.

WPPII's position on this issue has been considered and rejected by this Commission on *numerous* occasions, beginning with *AES Beaver Valley v. West Penn Power Co.*, Docket No. C-844022 (March 13, 1985). In fact, the Lehigh Valley Power Committee ("LVPC"), which is represented by the same law firm as WPPII, in the last several months has appealed two Commission Orders to the Commonwealth Court on this identical issue. The first appeal, at No. 1002 C.D. 1988, was argued before the Commonwealth Court on November 2, 1988. The second appeal, at No. 1620 C.D. 1988 was subject of a Commission brief filed with the Commonwealth Court on November 21, 1988. As we have noted over and over again, federal law expressly sanctions levelization of rates paid to qualifying facilities, our regulations require the payment of levelized rates, and there is nothing under federal law which defines or permits a concept of "ratepayers' avoided costs" separate from a utility's avoided costs. To the contrary, Congress and the Federal Energy Regulatory Commission ("FERC") have defined "full avoided costs", including levelized costs, as those which *are* just and reasonable to electric consumers. 16 U.S.C. § 824a-3(b) and (d); *American Paper Institute v. American Electric Power Service Corporation*, 461 U.S. 402

(1983). WPII's request essentially is a collateral attack upon the framework of FERC's regulations implementing PURPA, our own regulations implementing PURPA 210, and the numerous Commission Orders that have considered and rejected this issue in the past. An appropriate proceeding available to WPPII to raise this issue on a generic basis is the *Investigation upon the Commission's Own Motion Into the Regulations at 52 Pa. Code § 57.31 et seq.*, Docket No. I-860025, which was designed to review our PURPA 210 regulations and make any necessary or appropriate changes to them on a prospective basis. Absent any change to our regulations, rate levelization and rate recovery of levelized payments are required in Pennsylvania. Granting WPPII's petition for reconsideration on this issue therefore would serve no useful purpose, and simply would waste the parties' and our own time and resources, and needlessly delay the proceedings that of necessity must be concluded in as expeditious a manner as possible. Of course, our explicit recognition of the interlocutory nature of this and our September 30 Order preserves WPPII's right to appeal this issue at the conclusion of the proceeding. The issue of the levelization of payments to qualifying facilities and the rate recovery thereof being so fundamentally a cornerstone of our implementation of PURPA, we perceive no danger in excluding this issue from the scope of the proceeding prior to hearing.

The final pleading to be addressed is Armco/Allegheny's Petition for Reconsideration of October 17, 1988.[3]

---

[3] West Penn filed a Reply to Armco/Allegheny's Petition on October 31, 1988. West Penn requests that the Petition be denied except to the extent it requests that the September 30 Order be deemed interlocutory and to the extent that in West Penn's view the fundamental issue to be resolved is whether the proposed rates are at or below West Penn's avoided costs as calculated by West Penn's methodology, as opposed to the methodology set forth in the Commission's regulations.

Armco/Allegheny request that we reconsider certain aspects of our September 30 Order or, in the alternative, modify the Order to state that no final determination has been made regarding these aspects of our Order. Armco/Allegheny's alternative request, which is granted as set forth above, was made to prevent the necessity of filing an interlocutory appeal prior to the conclusion of the proceeding. Armco/Allegheny's other arguments focus on the statement in our September 30 Order at page 3 that "the fundamental factual issue to be resolved is whether the proposed rates are at or below West Penn's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31 *et seq.* If the rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically are recoverable from ratepayers." Armco/Allegheny's objection to this language is based on Section 527 of the Public Utility Code, 66 Pa. C.S. § 527, which states, *inter alia,* that "[T]he Commission shall require that utility rates to the public reflect savings to the utility from cogeneration." Armco/Allegheny have cited this statutory language as support for the somewhat novel proposition that our regulations implementing PURPA 210 cannot be used as the benchmark for determining the reasonableness of rates paid to qualifying facilities. This argument requires little attention. Suffice it to say that, absent a voluntary agreement otherwise, rates paid to a qualifying facility must be based under federal law on a utility's *full* avoided costs, and any state requirement that a qualifying facility involuntarily accept a lower rate would be preempted. As we are unaware of any support for Armco/Allegheny's assertion that the General Assembly intended to exempt Pennsylvania from the full avoided cost rule, we reject this argument. Statutes may be interpreted by presuming that the General Assembly did not intend to violate the Constitution of the United States. 1 Pa. C.S. § 1922(3).

Armco/Allegheny's second point on which it seeks reconsideration concerns our observation in our September 30 Order that we consistently have evaluated avoided costs as of the time negotiations between the utility and the developer occur, and our holding rejecting Armco/Allegheny's argument that, as a matter of law, the agreements must be evaluated with reference to West Penn's current avoided costs. But for the Section 527 argument, *supra,* Armco/Allegheny have not raised anything not previously considered on this point. Therefore, we deny their petition for reconsideration on this point, while noting that under the terms of the September 30 Order, parties are free to argue that circumstances unique to these proceedings justify a departure from this policy in this case.

Having addressed the various pleadings filed in response to our order of September 30, 1988; THEREFORE,

IT IS ORDERED:

1. That the proceeding at Docket No. P-870216 pertaining to the proposed power purchase agreement between West Penn Power Company and Milesburg, Inc. is consolidated with the proceedings at Docket Nos. P-880283, P-880284 and P-880286 for the purpose of hearing.

2. That the Order of September 30, 1988 and the Order of today's date are interlocutory, and all holdings set forth in these Orders will be subject to review by the filing of a Petition for Review upon the entry of a final Commission Order in these proceedings.

3. That the balance of the variously-styled Petitions for Reconsideration are granted or denied consistent with the foregoing opinion.

4. That a copy of this Opinion and Order be served upon all parties to above-captioned proceedings.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: January 19, 1989
ORDER ENTERED: January 19, 1989

APPENDIX K

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Docket Nos. P-870216
P-880283
P-880284
P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS

RE: MILESBURG ENERGY, INC.
MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

RECOMMENDED DECISION

Before
Larry Gesoff
Administrative Law Judge

TABLE OF CONTENTS

	Page
I. HISTORY OF THE PROCEEDINGS	119a
II. THE PROJECTS AND THE EEPAs	131a
A. The Milesburg Project	131a
B. The Monongahela Project	133a
C. The Burgettstown Project	136a
D. The Shannopin Mine Project	139a
PHASE I PROCEEDINGS	
III. DISCUSSION	142a
A. The Legal Standard to be Applied	142a
B. Burden of Proof	150a
C. Time Frame	151a
D. The Reasonableness of the Capacity Rates in the EEPAs	158a
1. WPP's Methodology	158a
2. Reserve Margin	161a
a. High Load Factors and Super-Critical Generating Units	169a
b. Generating Unit Availability	170a
c. Acid Rain Legislation	171a
d. Recommendation	171a
3. Coal Unit v. Combustion Turbine	173a
4. Mitchell and Springdale Units	180a
5. Fixed Charge Rate	183a
a. Cost of Capital	184a
(1) Capital Structure	185a
(2) Cost of Debt	185a

(3) Cost of Preferred Stock 186a
(4) Return on Equity 186a
b. State and Federal Taxes 187a
c.. Ad Valorem Rate (Insurance and Property Taxes) 188a
d. Rate Base 190a
e. Recommendation 191a
6. Section 527 of the Code 191a
7. OCA's Correction to the MEI EEPA 192a
8. Capacity Costs Allocated on a Demand/Energy Basis 195a
9. Excess Capacity 198a
10. Capacity Rate Recommendation 200a

PHASE TWO PROCEEDINGS

IV. THE PETITIONS FOR MODIFICATION 201a
A. MEI's Petitions 202a
B. The Burgettstown Petition 208a
C. Notice to Ratepayers 216a
V. RECOMMENDED ORDERS 217a
A. Recommended Milesburg Project Order 217a
B. Recommended Monongahela Project Order 217a
C. Recommended Burgettstown Project Order 218a
D. Recommended Shannopin Mine Project Order 219a

I. HISTORY OF THE PROCEEDINGS

On April 2, 1987 West Penn Power Company (WPP) filed a Petition for approval of an Electric Energy Purchase Agreement (EEPA) between it and Milesburg Energy, Inc. (MEI) and for advance approval for recovery through its energy cost rate (ECR) of all energy and capacity costs incurred under the EEPA. The Office of Trial Staff (OTS) and the Office of Consumer Advocate (OCA) filed answers to the Petition and Armco, Inc. and Allegheny Ludlum Corporation (AAL) jointly filed a Petition to Intervene and a Motion to Dismiss the WPP Petition. MEI intervened in support of the WPP Petition and filed responses to the pleadings of OTS, OCA and AAL.

On September 22, 1987, the Commission, without a hearing, entered an order accepting the WPP/MEI EEPA for filing under 52 Pa. Code § 57.32(c)(2)[1], determining that the EEPA was in the public interest, authorizing ECR recovery of expenses paid by WPP to MEI under the EEPA, and declaring that it will not consider additional generation capacity resulting from the EEPA in determining the reserve margins or economic benefits resulting from any base load or other generating unit during the term of the contract.

On October 9, 1987 WPP filed a petition for reconsideration of the Commission's Order entered September 22, 1987, requesting that the Commission publish its Order in the *Pennsylvania Bulletin* so that WPP's ratepayers would receive notice of the pass through to them of the capacity and energy charges incurred by WPP during the

---

[1] 52 Pa. Code §§ 57.31-57.39 contain the Commission's regulations governing the purchase and sale of energy and capacity between electric utilities and qualifying facilities (QF's) pursuant to Section 210 of the Public Utility Regulatory Policies Act (PURPA) 16 U.S.C. § 824a-3(a)-(j), and regulations promulgated thereunder at 18 C.F.R. §§ 292.101 *et seq.*

30 year duration of the EEPA.[2] On or about October 6, 1987, OCA petitioned the Commission to clarify and reconsider its Order entered September 22, 1987, specifically requesting that the Commission 1) clarify that its approval of the WPP/MEI EEPA has no impact on the base rate proceedings at Docket No. R-850220 (in which, at the time, excess capacity was being addressed on reconsideration on WPP's sought recovery of costs related to the Bath County pumped storage project (Bath County)), 2) clarify that the Order makes no findings regarding WPP's then present capacity situation, and 3) not apply its proposed policy statement on Section 1323 of the Public Utility Code (Code), 66 Pa. C.S. § 1323.[3] On or about October 6, 1987, AAL filed a Petition for reconsideration of the September 22, 1987 Order contending, among other things, that it was entered without a due process mandated hearing. WPP replied to the petitions of OCA and AAL.

By a vote of two to two at a public meeting held October 22, 1987, the Commission declined to grant reconsideration. WPP, OCA and AAL appealed separately from the Commission's September 22, 1987 Order and the Pennsylvania Commonwealth Court (Commonwealth

---

[2] In its original Petition, WPP requested that the Commission issue a declaratory order and publish it for public comment in the *Pennsylvania Bulletin*, but the Commission's Order did not so provide.

[3] Section 1323 provides for certain disallowances if the Commission finds that a utility has excess capacity as the result of claiming costs, for the first time, of an electric generating unit in its rates. Section 1323(c) creates an exception for certain cogeneration projects affecting the excess capacity analysis of certain baseload plants. The Commission's proposed policy statement regarding the treatment of purchases of capacity from QF's in excess capacity determinations was published for comment in the *Pennsylvania Bulletin* of July 18, 1987. Comments have been filed (at Docket No. L-870030), but as of this writing no action has been taken.

Court) consolidated the appeals. *Barasch, et al. v. Pennsylvania Public Utility Commission*, Nos. 2418, 2499 and 2522, C.D. 1987.

On December 31, 1987, January 5, 1988 and January 20, 1988, WPP filed petitions requesting approval of rate recovery of amounts paid pursuant to EEPAs with the developers of the Monongahela Lock and Dam No. 8 Project (Monongahela Project), the Burgettstown Project and the Shannopin Mine Project, respectively. In its petitions, as in the MEI petition, WPP requested ECR pass through, public notice and a comment period, and a finding of no excess capacity under Section 1323. OCA filed answers to all three petitions; Airco Industrial Gases filed petitions to intervene in all three petitions, but filed no answers; and AAL filed petitions to intervene in all three petitions, but filed answers only to the Burgettstown and Shannopin Mine Project. North Branch Energy Partners, L.P. (North Branch), the developer of the Burgettstown Project filed a petition to intervene in the proceeding at P-880284 and a statement in support of WPP's petition. Mon Valley Energy Corporation (Mon Valley), developer of the Shannopin Mine Project filed a petition to intervene in the proceeding at P-880286. WPP filed replies to the answers of OCA and AAL. North Branch filed responses to the answers of AAL and OCA to WPP's Burgettstown Project petitions. Mon Valley filed responses to the answers of AAL and OCA to the Shannopin Mine Project petitions. AAL filed a reply to the response of North Branch to AAL's answer to the Burgettstown Project petition.

The Commission, without a hearing, by Tentative Opinion and Order entered July 8, 1988, among other things, 1) granted all petitions to intervene, 2) approved the rates in all three EEPAs as just, reasonable and in the public interest, 3) authorized ECR recovery of all costs paid under the EEPAs, 4) declared that the capacity represented by the projects does not represent excess capacity

as to the capacity itself or as to any existing WPP capacity, 5) provided for publication of notice of the Tentative Opinion and Order in the *Pennsylvania Bulletin*, and 6) provided that the Tentative Opinion and Order would become final absent the filing of exceptions within 30 days of publication of the notice. Timely exceptions were filed by Mr. F. Alan Sever, the West Penn Power Industrial Intervenors (WPPII),[4] OCA, WPP, and AAL. WPP filed replies to the exceptions of WPPII, OCA and AAL.

After the Commission entered its Tentative Opinion and Order, Commonwealth Court on August 22, 1988, vacated the Commission's Order of September 22, 1987 (approving the WPP/MEI EEPA at Docket No. P-870216) and remanded the proceeding for Commission reconsideration of its declaration that the capacity credit proposed to be paid to MEI was in the public interest, and its declaration that it will not consider the capacity represented by the Milesburg Project in future West Penn excess capacity determinations. *Barasch, et al. v. Pennsylvania Public Utility Commission*, 119 Pa. Commw. 81, 546 A.2d 1296 (1988) (*Milesburg*). The Commonwealth Court concluded that the capacity credit proposed to be paid to MEI involved substantial property interests of WPP's ratepayers, and that these interests, in combination with the adjudicatory nature of the Commission's September 22, 1987 Order, required that ratepayers must be afforded due process. *Milesburg* at 1305. Accordingly, the Court held that, since payments for capacity were involved, the Commission should require West Penn to provide notice to its customers "in a manner consistent with that prescribed in 52 Pa. Code § 53.45(a), allowing for bill inserts in lieu of mailed or hand delivered individual notices." *Milesburg* at 1308. With regard to the opportunity to be heard, the Court held that "the [C]ommission

[4] In these proceedings, the WPPII group is comprised of Airco Industrial Gases, Latrobe Steel Co., PPG Industries, Inc. and Powder Metal Products, Inc.

must devise a procedure that provides the *essential elements of a hearing*, but allows for consideration of petitions of the type involved here *in as expeditious and minimally burdensome a manner as possible.*" *Milesburg* at 1307. (emphasis supplied)

In response to *Milesburg*, by Order entered September 30, 1988, the Commission consolidated the Monongahela, Burgettstown and Shannopin petitions and assigned them to the Office of Administrative Law Judge for hearing and recommended decision. WPP was directed to notify its customers of the three petitions by bill insert.

In the body of its Order, the Commission included two observations regarding the proper scope of the hearing. These are noted in some detail here because they provide a preliminary statement of some of the issues in these proceedings. The following contains part of the Commission's first observation:

> The Commonwealth Court has *not* imposed upon the Commission a requirement that petitions of the type involved here be subjected to an exhaustive proceeding in the nature of a general rate increase proceeding under Section 1308(d) of the Public Utility Code, 66 Pa.C.S. § 1308(d). Accordingly, we will direct the OALJ to limit the scope of discovery, the admission of testimony and evidence; and the cross-examination of testimony to issues that are relevant to our consideration of West Penn's petitions. In our view, the fundamental factual issue to be resolved is whether the proposed rates are at or below West Penn's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31 *et. seq.* If the rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically are recoverable from ratepayers. As we stated in our Tentative Opinion and Order, "the heart of the matter really is whether

> West Penn's projection of a need for capacity at the time that the three agreements were being negotiated was reasonable. If so, the payment of a capacity credit to the various developers is required by law." Tentative Opinion and Order at 22-23. An examination of this ultimate factual issue to be resolved will include an examination of several sub-issues of fact, including but not limited to projections of West Penn's installed capacity and customer demand. With respect to the appropriate reserve margin for West Penn, our Tentative Opinion and Order relied upon the two prior litigated Bath County proceedings at Docket Nos. R-842632 and R-850220 where we found the optimum reserve margin for West Penn was 28 percent. West Penn's projected need for capacity in the instant proceedings was based on a *lower* planning reserve margin of 25%. OCA's Exceptions to the Tentative Opinion and Order argue, *inter alia*, that the doctrine of collateral estoppel should not be applied to our prior findings on West Penn's appropriate reserve margins. We will leave the issue of whether collateral estoppel is properly applicable to our prior findings to the ALJ for his/her consideration and recommendation. (Mimeo at 3-4).

The Commission also rejects AAL's contention that as a matter of law the EEPAs must be evaluated with reference to WPP's current avoided costs as opposed to the time during which serious negotiations take place, which is the Commission's policy. The Commission, however, "leave[s] the issue of whether or not to consider arguments for a change in policy to the ALJ's discretion." Mimeo at 5. Finally, in its first observation, the Commission, noting that Commonwealth Court affirmed the Commission's policy of approving of levelized payments in agreements (including capacity payments before the date a utility projects a need for capacity), directs the ALJ to exclude the

issue of timing and of "inter-generational" inequity from the scope of the proceeding.

The Commission's second observation addresses the desirability to consolidate the Milesburg petition with the other three petitions. This was not possible at the time because the remand of the Milesburg record was stayed by applications for re-argument of the appeal. The Commission directed WPP to include the filing of the Milesburg petition in the same bill insert to facilitate future consolidation of all four proceedings. Finally, the Commission directed its advisory staff to calculate an estimated capacity credit to which the various developers would have been entitled under the Commission's regulations and to supply the calculations to the ALJ and the parties before the start of evidentiary hearings.

By Order entered October 27, 1988, the Commission responded to variously styled petitions for reconsideration of its September 30, 1988 Order filed by WPPII, AAL, North Branch and WPP. The Order grants reconsideration pending further consideration of the merits of the pleadings.

On January 19, 1989 the Commission entered its Opinion and Order on Reconsideration. In it the Commission notes that on November 3, 1988 the Commonwealth Court filed its opinion and order in *Milesburg*, among other things, holding that the Court's August 22, 1988 decision shall not be retroactive and shall apply only to the Milesburg petition and to petitions filed after August 22, 1988. Even so, the Commission voluntarily applied *Milesburg* to the Monongahela, Burgettstown and Shannopin petitions and consolidated all four proceedings for hearing and recommended decision. The Commission also directed that its Order of September 30, 1988 and the Order under discussion here (entered January 19, 1989) are interlocutory and that all holdings therein are subject to appellate review following entry of the Commission's final order. The Commission left to the assigned ALJ the

decision whether to grant WPP's request for a trial type hearing. While it did not set a firm deadline for the issuance of a Recommended Decision, the Commission requested that it be issued within two to three weeks after main briefs are filed, and suggested that the filing of reply briefs be eliminated.[5]

Also in the January 19, 1989 order, the Commission again rejects AAL's position on levelized rates and the time frame for determining avoided costs. In a slight change from its September 30, 1988 Order, the Commission stated that the "parties are free to argue that *circumstances unique to these proceedings* justify a departure from this [the Commission's time frame] policy in this case." Mimeo at 7. Also the Commission rejects AAL's argument under Section 527 of the Public Utility Code, 66 Pa. C.S. § 527. AAL asserts that because Section 527 directs the Commission to require that utility rates reflect savings to the utility from cogeneration, the Commission is prohibited from using its regulations as a benchmark for determining the reasonableness of rates paid to QF's. Mimeo at 6.

On August 4, 1988, while the *Milesburg* decision was pending, MEI filed a petition requesting 1) that a Commission investigation be opened, 2) that its EEPA with WPP be modified, and 3) that until further Commission Order, WPP be prohibited from constructing any generating unit whose construction would have been deferred by electricity purchases under the MEI/WPP EEPA. The contract modification sought is a two-fold reformation. First, MEI would be relieved of the September 1, 1988 deadline to obtain financing and all subsequent deadlines in the EEPA. Second, the contract would be reformed to require MEI to obtain financing under the EEPA not later than ninety days after a Commission order giving ad-

---

[5] As will be seen, the unforseen contingencies referenced in the Commission's order made it impossible to meet the Commission's requested schedule.

vance approval for recovery of all energy and capacity costs incurred becomes final and non-appealable. All other subsequent deadlines in the EEPA would be adjusted accordingly. This reformation was requested because Section 10.2 of the EEPA provided that if MEI did not obtain financing by September 1, 1988, the EEPA would terminate automatically. OTS, AAL, WPP, and OCA filed various styled responsive pleadings to MEI's Petition and MEI replied jointly to all four responses.

Reformation of a contract under Section 508 of the Public Utility Code, 66 Pa. C.S. § 508 does not become effective until 30 days of service of the Commission's reformation order, which itself must be preceded by notice and hearing. Because MEI's reformation petition was filed less than 30 days before the financing deadline, Section 508 was not available. For this reason, by Consent Order dated August 31, 1988, adopted by the Commission on September 1, 1988, the parties agreed to extend the financing closing date to February 28, 1988 and extend other dates accordingly. The automatic termination clause of Section 10.2 was maintained, subject to extension by further order of the Commission. The consent order also provided that "MEI shall not seek nor be entitled to any capacity credit higher than that specified in the agreement executed on or about February 25, 1987." AAL Ex. 80.

On January 10, 1989, WPP submitted to the Commission an affidavit verifying that the bill inserts referenced in the Commission's Order of September 30, 1988 had been served upon its customers beginning on October 21, 1988. The Affidavit also verifies that notices containing the same language were posted in WPP offices and collection agencies and appeared in newspaper advertisements and news releases.

On February 10, 1989, MEI filed another petition to modify its EEPA with WPP 1) to recalculate the capacity costs to reflect a later on-line date of the project and 2)

to extend the financing closing date and other milestone dates. (MEI's Second Petition for Modification) By Order dated February 21, 1989, without waiting for responses and without holding a Section 508 reformation hearing, I granted the relief requested because the financing closing date was due to elapse on February 28, 1989. By order dated February 27, 1989, I rescinded my order of February 21, 1989.

At the prehearing conference held on February 27, 1989 I gave the reasons for my rescission order. In brief, my February 21, 1989 order was in error because there was no hearing and because even if a Commission order reforming the contract was entered on the day the petition was filed, it would not become effective under Section 508 until *after* the financing deadline elapsed.

On March 3, 1989, MEI filed a Petition for Emergency Order or Appeal of Judge Gesoff's February 27, 1989 order. By Order entered March 31, 1989, the Commission denied the request for an emergency order but required all parties to maintain the status quo pending consideration of MEI's Second Petition for Modification. MEI also filed exceptions to my February 27, 1989 order.

On March 15, 1989 WPP filed a Petition for leave to withdraw its Petition for approval of the MEI EEPA (WPP's Withdrawal Petition) on the grounds that the issues in the proceeding have been rendered moot as the EEPA terminated automatically by its own terms. MEI filed an answer to WPP's Withdrawal Petition; WPPII filed a statement in support of the petition; and MEI filed a response to WPPII's statement.

On March 22, 1989, AAL filed a Motion to dismiss WPP's MEI EEPA petition on the grounds that WPP's EEPA with MEI no longer exists. MEI responded with a pleading, styled as a preliminary motion and answer, requesting that AAL's motion to dismiss be denied. WPP filed an answer to MEI's Motion.

On April 3, 1989, North Branch filed a petition requesting modification of its EEPA with WPP (the Burgettstown Project) to change the Financing Closing Date, currently October 1, 1989, to be six months from the date of the Commission's final order; to extend the Commencement Date and adjust all other dates accordingly; and to modify the capacity credit to reflect the modified project in service date. AAL, OCA and WPP filed answers to the petition.

MEI's Second Petition for Modification, WPP's Withdrawal Petition, AAL's Motion to Dismiss, and North Branch's Petition were litigated during Phase Two of these proceedings. Phase One consists of the hearing on the merits of WPP's petitions for approval of the four EEPAs.

As noted, the prehearing conference in this proceeding occurred on February 27, 1985. During the prehearing conference, I granted the motions of OCA, AAL, WPPII and North Branch to compel answers to interrogatories. This necessitated a ruling that the Commission's approval of WPP's reserve margin in two previous base rate proceedings concerning Bath County (R-850220 and R-842632) would not preclude reserve margin as an issue in this proceeding. See pages 19 and 20 of the transcript of the prehearing conference. Also, requests for depositions were granted, the request of the developer of the Monongahela Project to sever its petition (P-880283) was denied, and a schedule for the submission of pre-filed direct testimony, for the hearing and for briefs as set.

A trial type hearing was held. Eight days of hearing, from April 3 to April 12, 1989, produced 1475 pages of transcript. Twenty different witnesses testified, and 28 Statements and 162 Exhibits were admitted into the record. The parties litigating this proceeding—WPP, MEI, North Branch, Mon Valley, AAL, WPPII and OCA (neither OTS nor the Monongahela Project developer partici-

pated)—filed Main Briefs on May 16, 1989 and Reply Briefs on May 31, 1989.[6]

On May 12, 1989, MEI filed a Petition to Modify its petition to modify its EEPA. WPP and ALL filed answers.

The reader is directed to the tables appearing at the end of WPP's Main Brief. The tables list each witness and the statements and exhibits they sponsored. This is necessary since exhibits premarked by the parties with a witness's initials were changed so that each party's exhibits are numbered sequentially; the text of the statements referring to the exhibits was not changed, however, and the table is provided to help the reader locate the correct exhibit.

As can be determined by this history and by what follows, it was not possible for these proceedings to provide "the essential elements of a hearing" while allowing for Commission consideration "in as expeditious and minimally burdensome a manner as possible." *Milesburg* at 1307. Nor was it possible to adhere to the Commission's suggested timetable. It is hoped, however, that the Commission can devise a speedier, less burdensome proceeding for future utility/QF petitions while still preserving due process rights for all parties. This is necessary, in my opinion, to prevent Pennsylvania from being a hostile environment for future QF projects. The nature of these proceedings, therefore, should not be viewed by potential QF's, QF developers and other interested entities as a model for future proceedings.

---

[6] MEI, North Branch and Mon Valley submitted joint briefs which address common and individual interests. The Projects sponsored some witnesses and exhibits separately and some jointly. The joint briefs shall be referred to as BM&S Main Brief and BM&S Reply Brief. At times the three projects are referred to jointly as the Projects and sometimes individually, e.g., the Shannopin Project. Also the projects are sometimes referred to by project name and sometimes by developer name.

II. THE PROJECTS AND THE EEPAs

A. *The Milesburg Project*

This project is being developed and, if approved, will be operated by MEI which is owned by the Environmental Power Corporation. MEI St. 1 at 1.

The project will have a circulating fluidized bed boiler facility designed to burn bituminous coal refuse, to be located at the retired Milesburg Power Station in Milesburg, Centre County, Pennsylvania, previously operated by WPP and now owned by MEI. As a condition precedent to WPP's obligation to purchase capacity or energy from MEI, MEI must receive an Order from the Federal Energy Regulatory Commission (FERC), certifying that the Project is a QF under PURPA and the FERC regulations implementing PURPA.

The Project is expected to generate energy at an average rate in the range of 36.5 to 43 megawatthours per hour. The maximum installed capacity of the Project will be 43 megawatts. (The anticipated energy generation and capacity are subject to further revision pending final design.) The Project is located with WPP's service territory and power from the Project will be delivered by direct interconnection with the WPP system.

MEI and WPP executed an EEPA dated February 25, 1987, concerning the terms and conditions on which MEI will sell and West Penn will purchase power from the Project. A copy of the EEPA appears in this record as AAL Exhibit 11. In general, the EEPA provides for the sale by MEI and the purchase by WPP of all energy and capacity produced by the Project for a term commencing on or after January 1, 1990, and extending until the thirtieth anniversary of the Project's Commencement Date (as defined in the Agreement). The purchase price for such power consists of an energy component and, after the Project's Commencement Date, a capacity component.

The energy cost, as set forth in Section 1.2 of the EEPA, is a variable rate equal to WPP's Avoided Energy Cost Rate as defined in the EEPA. This rate will be based on West Penn's actual production costs at designated power generating facilities.

As set forth in Section 1.2 and 9.1 of the EEPA, after the Commencement Date a capacity cost will be paid at a fixed rate of 3.3¢/Kwh. According to WPP, this capacity cost is essentially equal to its estimate of its levelized present value of avoided capacity over the life of the Project as of May 27, 1986. WPP's methodology in determining its estimate of its levelized present value of avoided capacity is as set forth in Exhibit 2 attached to WPP's Petition for Approval of the EEPA.

WPP will retain a mortgage and security interest in all real and tangible personal property of the Project and a security interest in all intangible personal property of the Project, subject only to the liens, charges and encumbrances securing the Project debt or otherwise approved by WPP as set forth in Section 2.4 of the EEPA.

The pricing provisions of the EEPA are based on the long term estimated avoided capacity and energy costs of the Allegheny Power System (APS), of which WPP is a member company.

The capacity costs to be paid to MEI are levelized over the Project term. This levelization of capacity costs provides MEI with an up front revenue stream sufficient to cover Project debt service, as well as operation and maintenance expenses, during the initial portion of the Agreement by fixing the Project revenues at a rate higher than current actual avoided cost, since the capacity is not estimated to be needed until 1995. However, over the life of the Project, the present value of the capacity payments to MEI is designed to equal WPP's estimate of the present value of the capacity assumed to be delayed or avoided.

EEPA is subject to certain conditions precedent, including securing a final order from the Commission, satisfactory to WPP, allowing WPP a full and timely pass through to its ratepayers, via its ECR, of all charges payable by WPP under the EEPA. As a further condition precedent to WPP's obligation to purchase capacity or energy from the Project, MEI must execute an agreement to purchase the Milesburg Power Station pursuant to stated terms and conditions satisfactory to WPP. As noted above, MEI has purchased the power station.

B. *The Monongahela Project*

This project is being developed by the Noah Corporation (Noah), a South Carolina corporation.

Noah has applied for a FERC license to operate a hydroelectric generating station at Lock & Dam No. 8 on the Monongahela River located near Point Marion in Fayette County, Pennsylvania. As a condition precedent to WPP's obligation to purchase energy and capacity under the Agreement, such FERC license must be issued no later than January 1, 1990. The Borough of Point Marion has also received an Order from FERC, issued April 3, 1986 at Docket No. QF86-413-000, certifying that the Project is a qualifying facility (QF) under PURPA and FERC regulations implementing PURPA. This FERC certification will be transferred or assigned to Noah no later than January 1, 1990.

At current annual mean river flow and at the expected average operating head, it is anticipated that the Project will generate energy at an average rate in the range of 17,100 to 20,900 megawatthours per year at a maximum gross design capacity of 5.0 megawatts. (The anticipated energy generation and capacity are subject to further revision pending final design.) The Project is located within WPP's service territory and power from the Project will

be delivered by direct interconnection with the WPP system.

Noah and West Penn executed an EEPA dated June 15, 1987, concerning the terms and conditions under which Noah will sell and WPP will purchase power from the Project. The EEPA appears in this record as WPP Exhibit 15. In general, the EEPA provides for the sale by Noah and the purchase by WPP of all energy produced by the Project for a term commencing on or after October 1, 1991, and all energy and capacity produced by the Project for a term commencing on or after January 1, 1992. The purchase price for such power consists of an energy component and, after the Project's Commencement Date (as defined in the EEPA), a capacity component.

The energy cost is a variable rate determined as set forth in Section 1.2(a) of the EEPA and, following the Commencement Date, in Section 1.2(b) and Exhibit A to the EEPA. Before the Commencement Date the purchase price for Project energy delivered to WPP shall be based on West Penn's fuel and maintenance expenses as shown in FERC Accounts 501 and 510-514.

After the Commencement Date, the energy cost for the first fifteen years is 3.8¢/Kwh unless the "Tracking Account," as provided for in Section 1.3 of the EEPA, is zero; thereafter (or during any time during the first fifteen years when the Tracking Account is zero) the energy cost varies depending upon the formula set forth in Exhibit A but will not exceed WPP's avoided energy costs as defined in the EEPA, unless such avoided energy costs are below 3.8¢/Kwh.

As set forth in Section 1.2(b) and 9.1 of the EEPA, after the Commencement Date a capacity cost will be paid at a fixed rate of 3.6¢/Kwh, based on an in-service date of the avoided capacity in 1995.

It is expected that in the early years of the EEPA WPP's payments for energy will exceed its avoided costs for energy. Therefore, the EEPA in Section 1.3 provides for a "Tracking Account" which will keep track of any energy cost payments over avoided energy costs. After the fifteenth year, the balance in the Tracking Account which is excess over avoided costs will be utilized in the form of credits against required payments. As of April 18, 1985, the date when WPP delivered its formal quotation to Noah, it was expected that any balance in the Tracking Account would be exhausted by about the end of the twenty-sixth year of the Agreement. Based on WPP's fuel cost projections as of the date of Execution of the EEPA, which are subject to change, it was expected that the Tracking Account will be exhausted by the end of the forty-third year of the Agreement. If the Tracking Account is exhausted during the Project term, WPP will thereafter pay an energy cost of 3.8¢/Kwh plus one-half the difference of the avoided energy costs over 3.8 cents per kilowatthour.

The capacity cost of 3.6¢/Kwh is approximately equivalent to WPP's estimate, as of April 18, 1985, of its levelized present value of avoided capacity over the life of the Project. WPP's methodology in determining this estimate is set forth in Exhibit 2 to WPP's Petition for approval of the EEPA.

To protect its interest in the Project, WPP will be given a mortgage and security interest in all real and tangible personal property of the Project and a security interest in all intangible personal property of the Project, including the FERC license, subject only to the liens, charges and encumbrances securing the Project debt or otherwise approved by WPP.

The pricing provisions of the EEPA are based on the long term estimated avoided capacity and energy costs, as of April 18, 1985, of APS, of which WPP is a member company.

The capacity costs to be paid to Noah are levelized over the Project term. The energy costs to be paid to Noah are front loaded. West Penn has not utilized front loaded energy payments in PURPA negotiations except for hydroelectric projects.

The levelization of capacity costs and the front loading of energy costs provides Noah with an up front revenue stream sufficient to cover Project debt service, as well as operation and maintenance, during the initial portion of the Agreement by fixing the Project revenues at a rate higher than current actual avoided cost. The payback of the levelized capacity costs to utility ratepayers occurs in the later Project years the levelization begins to result in actual payments becoming lower than the projected avoided costs at such time.

For hydroelectric PURPA Projects, the energy costs exceeding avoided costs are recorded in a "Tracking Account" and may be recaptured in later years when avoided energy costs presumably will rise.

The EEPA is subject to certain conditions precedent, including securing a final order from the Commission, satisfactory to WPP, allowing WPP a full and timely pass through to its ratepayers, via its ECR, of all charges payable by WPP under the EEPA for the life of the EEPA. As further conditions precedent, the Project's FERC license must be issued no later than January 1, 1990 and the Financing Closing Date, (as defined in the EEPA) must occur on or before July 1, 1990.

C. *The Burgettstown Project*

This project is being developed by North Branch Energy Partners, L.P. (North Branch) whose offices are in Greensburg, Pennsylvania. The General partner of North Branch is North Branch Energy, Inc., a Pennsylvania corporation with its principal place of business in Greensburg, Pennsylvania.

The project will consist of a coal-fired cogeneration plant with two circulating fluidized bed boilers, one steam turbine generator and related facilities, to be located in Robinson Township, Washington County, Pennsylvania, approximately 9 miles northeast from Burgettstown, Pennsylvania. As a condition precedent to WPP's obligation to purchase capacity or energy from North Branch, North Branch must receive a FERC order certifying that the Project is a QF under PURPA and the FERC regulations implementing PURPA.

It is anticipated that the Project will generate energy at an average rate of 91 megawatthours per hour. While the maximum Contract Output (as defined in the EEPA) is equal to 80 megawatts, the gross design capacity of the Project will be approximately 91 megawatts. (The anticipated energy generation and capacity are subject to further revision pending final design.) The Project is located within WPP's service territory and power from the Project will be delivered by direct interconnection with the WPP system. In addition, the project will be fully dispatchable by WPP.

North Branch and WPP have executed an EEPA dated October 15, 1987, concerning the terms and conditions on which North Branch will sell and WPP will purchase power from the Project. A copy of the Agreement appears in this record as AAL Exhibit 24. In general, the EEPA provides for the sale by North Branch and the purchase by WPP of energy and/or energy and capacity produced by the Project beginning on or after April 1, 1991 and extending until the thirty-third anniversary of the Project's Commencement Date (as defined in the EEPA). The purchase price for such power consists of an energy component and, after September 30, 1991, upon the occurrence of certain conditions set forth in Section 1.2 of the EEPA, 50 percent of the Capacity Cost Rate (as defined in the EEPA) for the Contract Output (as defined in the EEPA). After the Project's

Commencement Date, a capacity component equal to the Capacity Cost Rate for the Contract Output will be included in the purchase price.

The energy cost, as set forth in Section 1.2 of the EEPA, is a variable rate equal to WPP's Avoided Energy Cost Rate as defined in the EEPA. This rate will be based on WPP's actual production costs at designated power generating facilities.

As set forth in Section 1.2 and 9.1 of the EEPA, after the Commencement Date a capacity cost will be paid at a fixed rate of 3.6 cents per kilowatthour, based on an in-service date of the avoided capacity in 1995.

The capacity cost of 3.6¢/Kwh is slightly lower than West Penn's estimate of its levelized present value of avoided capacity over the life of the Project as of October 6, 1986. WWP's method in determining its estimate of its levelized present value of avoided capacity is as set forth in Exhibit 2 to WPP's Petition for approval of the EEPA.

To protect its interest in the Project, WPP will retain a mortgage and security interest in all real and tangible personal property of the Project and a security interest in all intangible personal property of the Project, subject only to the liens, charges and encumbrances securing the Project debt or otherwise approved by WPP as set forth in Section 2.4 of the EEPA.

The pricing provisions of the EEPA are based on the long term estimated avoided capacity and energy costs of APS, of which WPP is a member company.

The capacity costs to be paid to North Branch are levelized over the Project term. The levelization of capacity costs provides North Branch with an up front revenue stream designed to be sufficient to cover Project debt service, as well as operation and maintenance expenses, during the initial portion of the EEPA by fixing the Project revenues at a rate higher than current actual avoided

cost, since the capacity is not estimated to be needed until 1995. However, over the life of the Project, the present value of the capacity payments to North Branch should essentially equal WPP's estimate of the present value of the capacity assumed to be delayed or avoided.

The EEPA is subject to certain conditions precedent, including securing a final order from the Commission, satisfactory to WPP, allowing WPP a full and timely pass through to its ratepayers, via its ECR, of all charges payable by WPP under the Agreement.

West Penn intends to treat purchases from the Project as interchange purchases allocable solely to Pennsylvania.

D. *The Shannopin Mine Project*

This project is being developed by Mon Valley Energy Corporation (Mon Valley). Mon Valley is a Pennsylvania corporation with its principal office in Pittsburgh, Pennsylvania.

The Project will consist of a coal-fired cogeneration plant with a circulating fludized bed boiler and related facilities, to be located at Poland Mines, in Greene County, Pennsylvania. As a condition precedent to WPP's obligation to purchase capacity or energy from Mon Valley, Mon Valley must receive a FERC order certifying that the Project is a QF under PURPA and the FERC regulations implementing PURPA.

While the maximum Contract Output (as defined in the EEPA), is equal to 80 megawatts, the gross design capacity of the Project will be approximately 89 megawatts. (The anticipated energy generation and capacity are subject to further revision pending final design.) The project is located within WPP's service territory and power from the Project will be delivered by direct interconnection with the WPP system. In addition, the Project will be dispatchable by WPP.

Mon Valley and WPP executed an Electric Energy Purchase Agreement dated October 15, 1987, concerning the terms and conditions on which Mon Valley will sell and WPP will purchase power from the Project. A copy of the EEPA appears in this record as AAL Exhibit 40. In general, the EEPA provides for the sale by Mon Valley and the purchase by WPP of energy and/or energy and capacity produced by the Project beginning on or after March 1, 1992 and extending until the thirtieth anniversary of the Project's Commencement Date (as defined in the EEPA). The purchase price for such power consists of an energy component and, after August 31, 1992 and before the Commencement Date, upon the occurrence of certain conditions set forth in Section 1.2 of the EEPA, 50 percent of the Capacity Cost Rate (as defined in the EEPA) for the Contract Output (as defined in the EEPA). After the Project's Commencement Date, a capacity component equal to the Capacity Cost Rate for deliveries up to the Contract Output will be included in the purchase price.

The energy cost, as set forth in Section 1.2 of the EEPA, is a variable rate equal to WPP's Avoided Energy Cost Rate as defined in the EEPA. This rate will be based on WPP's actual production costs at designated power generating facilities.

As set forth in Section 1.2 and 9.1 of the EEPA, after the Commencement Date the Capacity Cost Rate will be a fixed rate of 4.0 cents per kilowatthour, based on an in-service date of the avoided capacity in 1995.

The Capacity Cost Rate of 4.0¢/Kwh is slightly lower than WPP's estimate of its levelized present value of avoided capacity over the life of the Project as of September 1986. WPP's methodology in determining its estimate of its levelized present value of avoided capacity is as set forth in Exhibit 2 to WPP's petition for approval of the EEPA.

To protect its interest in the Project, WPP will retain a mortgage and security interest in all real and tangible personal property of the Project, and a security interest in all intangible personal property of the Project, subject only to the liens, charges and encumbrances securing the Project debt or otherwise approved by WPP as set forth in Section 2.4 of the EEPA.

The pricing provisions of the EEPA are based on the long term estimated avoided capacity costs and the actual energy costs of specified generating units of APS, of which WPP is a member company.

The Capacity Cost Rate to be paid to Mon Valley is levelized over the Project term. The levelization of the Capacity Cost Rate provides Mon Valley with an up front revenue stream designed to be sufficient to cover Project debt service, as well as operation and maintenance expenses, during the early years of the Agreement by fixing the Project revenues at a rate higher than current actual avoided cost, since the capacity is not estimated to be needed until 1995. However, over the thirty-year life of the Project, the present value of the capacity payments to Mon Valley is slightly lower than West Penn's estimate of the present value of the capacity assumed to be delayed or avoided.

The EEPA is subject to certain conditions precedent, including securing a final order from the Commission, satisfactory to WPP, allowing WPP a full and timely pass through to its ratepayers, via its ECR, of all charges payable by WPP under the EEPA.

West Penn intends to treat purchases from the Project as interchange purchases allocable solely to Pennsylvania.

PHASE I PROCEEDINGS

III. DISCUSSION

A. *The Legal Standard to be Applied*

Although the Commission has specific regulations governing the calculation of avoided costs, the rates set forth in the EEPAs in question were calculated under WPP's methodology. The parties differ about how to determine if the EEPA rates are at or below WPP's avoided costs.[7] Before discussing the parties' positions it is necessary to review briefly the legislation pertaining to non-utility generation.

PURPA became law in 1978. It is an attempt by Congress to increase the use of renewable energy resources and, in so doing, further this country's efforts to become energy independent. In PURPA, cogeneration facilities are characterized by the sequential production, from one fuel source, of electric energy and steam that can be used for industrial or commercial purposes. Small power production facilities are defined as those that produce electric energy by the use of biomass, waste or renewable resources and have a generating capacity of 80 MW or less. To encourage development of these facilities, Congress created a class of qualifying facilities that was to be exempt from the bulk of federal and state regulation.

Section 210 of PURPA, 16 U.S.C. § 824a-3(a), requires electric utilities to purchase power from cogenerators and small power producers (hereafter QF's). PURPA states that the rates for such purchase:

> (1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

---

[7] The reasonableness of the energy rates has not been challenged; future references refer to capacity rates. See AAL Main Brief at 3.

> (2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

PURPA adds that:

> No such rule prescribed under subsection (a) of this section shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.

16 U.S.C. § 824a-(b).

PURPA provides that a QF selling power is exempt from FERC provisions requiring general ratemaking approval for sales between electric utilities if the sales of QF power conform to an "incremental cost" standard. The term "incremental cost of alternative electric energy" is defined as "the cost to the electric utility of the electric energy which, but for the purchase from such [QF], such utility would generate or purchase from another source." 16 U.S.C. § 824a-3(d). This rate standard has been termed by FERC, and generally adopted by the industry, as "avoided costs." 18 C.F.R. § 292.101(b)(6).

PURPA required FERC and State regulatory authorities to adopt rules governing the sale of QF power. As noted in footnote 1, *infra,* FERC and this Commission have done so.

The Commission's Order of September 29, 1988, page 3, defines the issue in this proceeding as follows:

> In our view, the fundamental factual issue to be resolved is whether the proposed rates are at or below WPP's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31, *et seq.* If the rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically recoverable from rate payers.

WPP maintains that the purchase rates in the EEPAs are below its avoided costs under either its methodology or

the Commission's regulations. For that reason, WPP concludes that the issue of what standard to apply is not critical. WPP Main Brief (M.B.) at 6-7.

The Projects insist that the formula in the Commission's regulations is the only legally recognized method of calculating WPP's avoided capacity costs. BM&S M.B. at 41-44. The Projects conclude that the reasonableness of the avoided capacity rate in the EEPAs must be measured against the avoided capacity rate calculated under the Commission's regulations.

AAL [8] insists that privately negotiated contracts are outside the scope of the federal and state cogeneration regulations, and it would be improper, therefore, to use those regulations as a standard against which to measure the justness and reasonableness of the rates in this proceeding. Instead, AAL argues that the capacity credits [9] negotiated by WPP must be below its true avoided cost and also provide "savings" to ratepayers under Section 527 of the Code. (AAL's Section 527 argument is discussed and rejected in Section III D 6 below.) AAL also argues that capacity payments under the Commission's regulations exceed avoided costs. AAL concludes that a correct determination of WPP's avoided cost is the initial benchmark against which privately negotiated capacity payments must be judged and that the Commission must insure that the negotiated rate is "some increment" below true avoided cost (its Section 527 argument). AAL M.B. at 37-48.

OCA argues that the Commission's regulations are not applicable to the rates established in the EEPAs of this case based upon the language of the regulations and the

---

[8] Although AAL and WPPII each consist of more than one entity I refer to them in the singular.

[9] AAL uses the term capacity *credits* because the Commission's regulations use the same term. It is a confusing term, however, and I refer to them as capacity *payments* or *rates*.

Milesburg decision interpreting these regulations. OCA asserts also that because the regulations do not discount the future value of capacity in setting current rates, the regulations produce rates which are in excess of "incremental costs" and must be considered to violate the rate limitations set forth in PURPA. Even if it is determined that the regulations apply, OCA asserts, the regulations would produce a zero capacity rate as the regulations defining a committed unit or a proxy unit were inapplicable given the facts of this case. Finally, OCA argues that if it is determined that the majority of the WPP assumptions concerning the calculation of the capacity rates were valid, the rates under the regulations are still less than the rates provided for in the EEPAs as such rates should have been calculated based upon the selection of a combustion turbine (CT) rather than the WPP coal units. As a result, OCA concludes, the application of the regulations to the EEPA rates in this case does not support a determination as to the rates which should be approved.

In support of their positions, AAL and OCA rely on the same Commission and FERC regulations and on *Milesburg*. The FERC regulation at 18 C.F.R. § 292.301 (b)(1) reads as follows:

> Nothing in this subpart:
>
> (1) limits the authority of any electric utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart.

The Commission's regulation at 52 Pa. Code § 57.32(a) provides that:

> Furthermore, as detailed in subsection (c), nothing in this subchapter will affect existing contracts or future contracts freely entered into by utilities and qualifying facilities.

52 Pa. Code § 57.32(c) provides in part that:

> (1) Nothing in this subchapter:
>
> (i) Limits or extends the authority of an electric utility to agree to a price for a purchase or to terms or conditions relating to a purchase which differ from the terms or conditions which would otherwise be required by this subchapter.

In *Milesburg*, the Commonwealth Court discussed the relationship between privately negotiated QF contracts and the federal and state regulations as follows:

> The regulatory scheme adopted by FERC also permits utilities and QFs to negotiate agreements for utility purchase of power independently of the prescribed rates. 18 C.F.R. Section 292.301. Thus, even if a state chooses to implement the FERC regulations by adopting rules of its own prescribing a purchase rate in detail, a utility and a QF may still negotiate a different rate, using the state-prescribed rate as a base line. Because no large utility is exempt from the FERC regulation that requires filing of detailed utility cost data and projections with the State Regulatory Authority, 18 C.F.R. § 292.302, a QF negotiating an agreement with a utility knows what rate it could compel if the utility fails to bargain in good faith. Although privately negotiated contracts setting rates for QF power are essentially outside the federal and state rules, state public utility commissions have a duty to examine costs of such contracts claimed by a utility for the purpose of setting its own rates, and will disallow those found to be excessive. Therefore, the state regulatory authority plays an indirect role in the negotiating process.

Milesburg at 1300. AAL also relies on *Petition of Pagnotti Enterprises, Inc.*, P-870281 where the Commission in its August 18, 1988 Order, granting reconsideration of a previous order, stated as follows:

> Generally, however, negotiated agreements between utilities and QFs take precedence over the terms and conditions that otherwise could be required by our regulations.

Based on the foregoing, AAL concludes that it is a "point of law" that privately negotiated contracts are "essentially outside the federal and state rules" and that, therefore, it is improper to judge the reasonableness of the EEPA capacity payments by comparing them to rates calculated under the state regulations. AAL M.B. at 39. OCA concludes that the Commission and FERC regulations indicate an intention not to "affect" EEPAs voluntarily entered into and that rates calculated under the Commission's regulations provide no basis upon which the EEPA rates may be approved for recovery by WWP. OCA M.B. at 72-73. I disagree.

In *Milesburg*, the Commonwealth Court recognized that a utility and a QF may negotiate a rate different than that prescribed in the Commission's regulations, *"using the state-prescribed rate as a base line." Milesburg* at 1300. (emphasis added) A negotiated contract is "outside" the Commission regulations only to the extent it contains terms and rates other than those prescribed by the regulations. This does not mean the regulations cannot be used as a measuring rod. There is no "point of law" (whatever is meant by that term) that prohibits the Commission from concluding, as it did in its Order of September 29, 1988, cited above, that if the rates are at or below the avoided costs to which the QF would be entitled as a matter of law (i.e., as defined by the Commission regulations), the rates are *per se* reasonable. The formula in the regulations was promulgated by the Commission in response to the PURPA mandate. Until invalidated by the Commonwealth Court [10] or

---

[10] WPP has challenged the validity of the Commission regulations computing capacity payments. The proceeding, at Commonwealth Court Docket No. 91 CD 1983, is pending.

changed by the Commission [11], the formula is the state-prescribed method of arriving at avoided costs and must be used by the Commission to judge the reasonableness of avoided costs set forth in agreements negotiated by a utility and a QF.

Anticipating reliance on the "base line" statement in *Milesburg*, AAL refers to it as follows:

> . . . it should be recognized that an *assumption* underlying this statement *must have been* that the state-prescribed rate under the state regulations would result in a capacity credit that was equal to true avoided cost.[5] However, as discussed *infra*, the testimony in this case clearly demonstrates that the capacity credits calculated pursuant to the state regulations invariably result in rates greatly in excess of avoided cost. Comparing a negotiated rate with a rate which is without question greater than true avoided cost is of no value. Thus, *the court must have intended* the parties to compare the negotiated rate with a rate which is an accurate determination of WPP's true avoided cost. (footnote omitted; emphasis added)

AAL M.B. at 40. AAL's reasoning is based on speculation. The issue of whether the Commission's regulations calculate rates in excess of avoided cost was not discussed by the Commonwealth Court in *Milesburg*. AAL is reduced, therefore, to judicial mindreading to support its position. This is most certainly a method inferior to interpreting the plain and clear meaning of the Court's words, namely, that the avoided costs set by the Commission's regulations can be used as a baseline against which to measure the rates set in the EEPAs in question.

OCA and AAL argue that the capacity payments calculated under the Commission's regulations cannot be

[11] The Commission's proceeding at I-860025 is re-examining the cogeneration regulations and could result in changes in the formula.

used as a baseline because they exceed avoided costs. OCA M.B. at 73-80; AAL M.B. at 40-44. While they might be correct, this is not the correct proceeding within which to determine the accuracy of the Commission's calculation of avoided costs. As noted in footnotes 10 and 11 above, two other proceedings address this issue and it would be improper to rule on the accuracy of the regulations here. As noted, until invalidated by Commonwealth Court or changed by the Commission, the regulations are valid as they are.

Even though the regulations cannot be challenged here, and even though they can be used as a baseline, the evidence in this record does not support the use of calculations under the regulations *in these proceedings.*

Only WPP calculated avoided costs under the Commission's regulations. (The Commission Staff calculation (ALJ Ex. 1) was submitted without a sponsoring witness and carries no weight because it is hearsay evidence.) WPP's calculation, however, cannot be accorded much evidentiary value.

WPP witness Kave made the calculation even though he does not believe the calculation to be appropriate for the determination of WPP's avoided costs. WPP St. 1-S at 1. Mr. Kave noted that WPP has appealed these regulations on the basis that they overstate avoided costs. WPP St. 1-S at 2. When asked why he characterized his calculations of the rates under the Pennsylvania Regulations as estimates, Mr. Kave responded that:

> The actual calculation which would have to be performed for a more precise determination would depend upon a number of unknown factors. For example, the capacity rate calculation for a project would be performed at the time of acceptance by the qualifying facility (QF) [§ 57.34(c)(1)]. This could impact the determination of CB, the booked construction costs. I have no way of precisely know-

> ing on what date the QF would have accepted a calculation under the Pennsylvania Regulations.
>
> * * * *
>
> In addition, after initial rates have been established, certain adjustments occur to the capacity and energy rates . . . No attempt has been made to estimate these adjustments.

WPP St. 1-S at 3-4.

Owing to the nature of the calculation of avoided costs in the Commission's regulations and owing to the slight evidentiary value which can be given to the only calculation sponsored by a witness in this proceeding, the reasonableness of the capacity costs in the EEPAs in question should be measured against WPP's methodology, not the Commission's regulations. *This determination is limited to these proceedings.* It should not be applied to future proceedings where different record evidence is available.

B. *Burden of Proof*

The OCA in its Main Brief argues that WPP must meet a heavy evidentiary burden in this proceeding:

> The Pennsylvania Supreme Court has made it clear that the party with the burden of proof has a formidable task before its position can be adopted by the Commission. Even where a party has established a prima facie case, the litigant still must establish that 'the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, *precluding all reasonable inferences to the contrary.*' *Burleson v. Pa. PUC*, 501 Pa. 433, 437, 461 A.2d 1234, 1236 (1983) (emphasis added).

OCA M.B. at 16.

This proceeding is not a proceeding upon motion of the Commission and, therefore, the burden of proof enunciated in Section 315 of the Code, 66 Pa. C.S. § 315, does not apply. As the proponent of a rule or order, WPP has the burden of proof. Section 332(a) of the Code, 66 Pa. C.S. § 332(a). It is the duty of the party with the burden of proof to produce substantial evidence which, if believed, warrants the decision sought. *Smith v. Bell Telephone Co. of Pa.*, 397 Pa. 134, 139, 153 A.2d 477, 480 (1959). Substantial evidence is "that quantum of evidence which a reasonable mind might accept as adequate to support a conclusion." *Norfolk and Western Ry. Co. v. Pennsylvania Public Utility Comm'n*, 489 Pa. 109, 128, 413 A.2d 1037, 1047 (1980). No particular type of evidence is required; the only requirement is that the evidence as a whole be legally sufficient to support the order of the Commission. *Motor Freight Express v. Pennsylvania Public Utility Comm'n*, 180 Pa. Super. 622, 627, 121 A.2d 617, 620 (1956).

WPP's burden is not as formidable as OCA states it is. WPP must meet its burden of proof by substantial evidence, however, and the record in these proceedings will be examined in that light.

C. *Time Frame*

As noted, in the above History of the Proceedings, in its January 19, 1989 order, the Commission stated that the parties are free to argue that circumstances unique to these proceedings justify a departure from its policy that the appropriate time for determining avoided costs is the time during which serious negotiations take place.

WPP justifies its calculations of avoided costs as of the time of agreement in principle on rates and argues that AAL has not shown any unique circumstances to justify a departure from the Commission's policy. WPP M.B. at 44-51. The Projects cite the indicia of serious negoti-

ations enunciated by the Commission in *Pa. P.U.C. et al. v. Duquesne Light Company,* R-860556C001 (Order dated July 20, 1987) (*Duquesne*), and equate the serious negotiations standard to the period when WPP and the representatives of each Project discussed an agreement in principle on rates, but before WPP internally formulated the price. BM&S M.B. at 29-41. AAL argues that the Commission should use the time of the signing of the contracts in question because to do otherwise would deprive ratepayers of the consequences of two major tax changes which were enacted before the contracts were signed. AAL M.B. at 26-36. OCA uses WPP's agreement in principle dates. OCA St. 1 at 6-7; OCA M.B. at 19.

The negotiation process between a cogeneration project developer and a utility is lengthy and complicated. (See generally BM&S M.B. at 6, 8-10, 12 and the transcript and statement references made there.) WPP witness Kave describes WPP's negotiation process in WPP Statement 1, his direct testimony. He states as follows:

> West Penn is part of an integrated utility system known as the Allegheny Power System. The negotiation of PURPA contracts for West Penn and its sister companies, Monongahela Power Company and The Potomac Edison Company, is conducted on a centralized basis by the Allegheny Power Service Corporation ("APSC"). Since generation planning is done on a system-wide basis, avoided cost rates for eligible qualifying facilities are also determined on a system-wide basis. The paramount concern during such negotiations is that qualifying facilities who desire to avoid capacity must provide firm, reliable capacity at rates no greater than avoided costs.

WPP St. 1 at 4.

After a QF contact, WPP [12] receives information from the QF regarding size, type of project, location and schedule for deliveries. During later meetings to discuss purchase rates, project characteristics and negotiating guidelines, WPP tries to determine what the QF wants from WPP, if the QF can provide firm, reliable capacity, and if an agreement on purchase rates can be reached. If a price is agreed upon (the agreement in principle on rates), a formal Project Price Proposal, if approved by WPP management, is sent to the QF. This Proposal is an offer by WPP to purchase capacity and/or energy from the QF for a specific term and in-service date, subject to an ultimate agreement on all the terms and conditions. The proposal remains valid for a period of 3 months while negotiations are completed on the basic business arrangement, called a term sheet. Upon completion of a term sheet, customized for each project, a contract (the EEPA) is negotiated, drafted, finalized, and filed with the Commission for approval. WPP St. 1 at 4-5.

According to Mr. Kave:

> The crucial point in the negotiation process is the agreement in principle on purchase rates, which are recommended to senior management for inclusion in a formal Project Price Proposal. Prior to the acceptance of purchase rates, APS has very little confidence that the parties will be able to proceed with the transaction and that APS will be able to avoid the construction of capacity. Typically, a QF is unwilling or unable to commit to sell power in any amount or for any specific length of time absent an agreement on rates. On the other hand, once an agreement in principle on rates is reached and a QF is willing to proceed, APS believes, for reasons I will

[12] In the following discussion APS and WPP are used interchangeably owing to the centralized negotiation of WPP's PURPA contracts.

> PURPA developer would commit to provide capacity if the rates were too low. Consequently, if there is no agreement on purchase rates, then there is no sound basis for avoiding capacity.

WPP at 10-11.

For the Milesburg Project an agreement in principle on purchase rates was reached in May 1986; a firm price proposal was sent on May 27, 1986. WPP St. 1 at 21. For the Burgettstown Project the dates are October 1986 and March 3, 1987, respectively. WPP St. 1 at 23. For the Shannopin Project the dates are September 1986 and October 17, 1986, respectively. WPP St. 1 at 24. For the Monongahela Project the dates are April 1985 and April 18, 1985, respectively. WPP St. 1 at 22.

AAL criticizes WPP's negotiation process, pointing out that its length renders the serious negotiations concept nebulous and allows for significant changes to take place which would alter the calculation of the capacity cost. AAL adds that during the negotiations of the EEPAs in question, interest rates fell, other projects negotiated with WPP, and two major tax changes were enacted. AAL then asks the question: "Should the QF developer be allowed to choose the point in time during the two years or so of 'serious negotiations' that generates the highest capacity cost rate?" AAL M.B. at 29. In my opinion, the correct response to this is another question: Should AAL be allowed to choose the point in the negotiation process that generates the lowest capacity cost rate? The answer to both questions is "no". Objective criteria are needed and must be applied consistently to give reliability (with respect to time frame) to utility/QF negotiations.

Next, AAL criticizes WPP for being bound by an oral agreement in principle as opposed to a written contract especially since the interim written documents, the term sheets, state that they are not binding regarding any

> explain later in my testimony, that there is sufficient assurance to assume that capacity costs will be avoided for planning purposes.

WPP St. 1 at 9. He explains why APS requires the QF to agree to a rate before issuing a Project Price Proposal as follows:

> By definition, avoiding capacity means that West Penn would include the QF capacity in the APS Integrated Resource Plan, defer or cancel new construction, and commit to a dependence on the QF capacity for serving its customers. Such a reliance on outside resources cannot be taken lightly. APS has received hundreds of contacts system-wide from new developers and existing cogenerators who have indicated a desire to sell power if acceptable terms could be reached. Less than 10% of these contacts have resulted in commitments to sell power. If all of these contacts, meetings, and negotiations were considered to be commitments to be included in the APS Integrated Resource Plan, West Penn's and APS's future plans would be nonsense.
>
> Experience has shown that there is no commitment to provide capacity until an agreement in principle on purchase rates is reached. Even then, the commitment is somewhat tenuous, and must be relied upon with caution. Consequently, we feel that capacity planning and the concepts of avoided costs require that agreement on purchase rates be the starting point for determining the level of commitment of potential PURPA projects.
>
> To issue a Project Price Proposal during exploratory discussions with the developer, when there is no commitment or agreement in principle on purchase rates, is unjustified. Practically all PURPA developers would commit to provide capacity if the purchase rates were high enough; conversely, no viable

provision including the price to be paid for Project Energy. AAL argues that WPP's ratepayers should not be bound long in advance of a written contract and "in defiance of beneficial changes" occurring before the contract is signed while the QFs are, as a practical matter, not bound at all. AAL M.B. at 31-32.

AAL's argument misses the point. The beneficial changes it refers to (particularly the Tax Reform Act of 1986 (TRA-86), which reduced the corporate federal income tax rate and the reduction of the Pennsylvania Corporate Net Income Tax (CNI) rate on January 1, 1987) could as easily have been detrimental to WPP's ratepayers. In other words, the tax rates could have been increased instead of decreased. If so, AAL, the two members of whom are WPP ratepayers, would probably argue in favor of a time earlier than the enactment of TRA-86 and the reduction of the CNI, a time such as agreement in principle on rates.

The reason for WPP's reliance on the time of agreement in principle on rates is that APS has determined, as a result of experience in negotiations with QFs, that at this time its risk of relying on a project's capacity for planning purposes is significantly reduced. WPP St. 1 at 9, Tr. 83-86, 297. This is important for WPP because it has a duty to serve its customers pursuant to Section 1501 of the Code, 66 Pa. C.S. § 1501.

On page four of its September 30, 1988 order in these proceedings, the Commission gave the reasons for its time frame policy:

> In order to prevent avoided cost rates from evolving into a constantly moving target, and to prevent utilities from depriving qualifying facilities of avoided cost rate entitlement by delaying negotiations, we consistently have evaluated avoided costs by reference to the time period during which serious negotiations take place . . . FERC's preamble to its regula-

> tions states, inter alia, that use of the term "legally enforceable obligation" is intended to prevent a utility from circumventing the requirement that provides capacity credit for an eligible qualifying facility merely by refusing to enter into a contract with the qualifying facility.

See, preamble to 18 C.F.R. §§ 292.304(b)(5) and (d), 45 Fed. Reg. 12224, February 25, 1980. There are other reasons to pick a consistently applied time frame. Most QF's depend upon their revenue stream from the utility to repay loans because most QF projects have very little equity invested. Accordingly, without a firm commitment on price from a utility, financing is difficult to obtain because lenders require evidence of a guaranteed revenue stream before financing the project. Without such a commitment to a revenue stream, contractors and engineers will be reluctant to submit bids on the project and the permitting process could be jeopardized. MEI St. 1 at 1-7; WPP St. 2 at 3-7; Tr. 8-9, 33-34, 393-394, 400-402.

Ultimately, no matter what time is used to fix EEPA purchase rates, the ratepayers bear a risk that avoided costs will go down after that time and the QF bears the risk that avoided costs will go up. As noted, WPP sets the times of agreemnt in principle on rates as May 1986, October 1986, September 1986 and April 1985 for the Milesburg, Burgettstown, Shannopin and Monongahela Projects, respectively. I accept these dates as times when serious negotiations were taking place under the Commission's definition thereof as set forth in *Duquesne.* Under *Duquesne,* some indicia of serious negotiations are:

> (1) evidence of FERC certification granting qualifying status to the facility; (2) a statement of project definition including preliminary project design; (3) letter of intent or similar evidence of host site control; (4) evidence of adequate fuel supply consistent with anticipated project life and energy produc-

tion; (5) a plan for obtaining all necessary project licensing; and (6) preliminary evidence of financial feasibility of project and a preliminary financing plan.

Duquesne at 5; See also *City of Pittsburgh v. Duquesne Light Company*, C-871584 (Opinion and Order entered October 6, 1988). While the list in *Duquesne* is not all inclusive, evidence of a project making substantial progress toward meeting the indicia can be considered as evidence of serious negotiations.

Based upon this record, for all projects, WPP's time of agreement in principle on rates meets the Commission's definition of serious negotiations. MEI St. 1 at 4-7; MEI Ex. 1; Tr. 88, 90, 101-102, 119; Burgettstown Sts. 5, 5-B and 6-A; WPP St. 1 at 23; Tr. 372, 1253; Shannopin St. 1; BM&S St. 1; Tr. 250-251. AAL has not shown any unique circumstances to justify a departure from the Commission's policy.

D. *The Reasonableness of the Capacity Rates in the EEPAs*

1. *WPP's Methodology*

WPP's methodology for calculating the avoided costs in the EEPAs is set forth in WPP Exhibit 1 and described in WPP Statement 1 at pages 15-20 generally and at pages 20-24 for each Project. WPP's methodology is included in a report captioned "The Value of Generating Capacity". WPP Ex. 1. WPP's methodology calculates avoided costs by determining the amount of overlap between the QF's supply of capacity and the APS need for capacity. This overlap shows how much capacity (in months) can be avoided by recognizing the in-service date and economic life of the APS plant as well as the in-service date and contract term of the QF. These avoided costs are spread over the QF contract term as a levelized rate such that the present value of the avoided

APS plant costs equals the present value of the payments to the QF. According to Mr. Kave, these equivalent present values ensure that the ratepayers pay no more for QF capacity than the avoided costs of the APS plant, regardless of the in-service date and contract term of the QF. WPP St. 1 at 15-16.

The APS need for generating capacity is determined from the APS Integrated Resource Plan which, for these Projects, showed that new, avoidable generating capacity would be needed in the form of three, 300 Mw coal-fired units. These units were included as a part of WPP's annual system cost data filing (52 Pa. Code § 57.33) and the annual resource planning report (52 Pa. Code § 57.49). Mr. Kave states that these units are also consistent with the coal proxy definitions used within the Commission's regulations. WPP St. 1 at 16.

The rates in cents per Kwh will differ among projects depending on the length of the contract term and the QF's in-service date. Generally, the closer a QF's in-service date is to WPP's need for capacity, and the longer the contract term overlaps the life of the avoided plant, the greater the costs are that can be avoided.

Similarly, avoided capacity rates differ depending on when the next APS plant is needed. That is, for a given QF contract term and in-service date, the rate may change if the APS Integrated Resource Plan changes. All other things being equal, the farther into the future the next need for an APS plant, the lower the avoided capacity cost rates will be under APS's methodology. This tends to discourage capacity additions by QFs that are not needed. Conversely, if there is a near term need for capacity, the methodology tends to encourage QF development by offering higher rates. According to Mr. Kave, this sensitivity to forces of supply and demand creates a built-in safeguard against excess capacity problems. WPP St. 1 at 17.

Another reason that capacity rates may differ among projects is that capacity rate calculations are performed using standard APS information and estimates which are available at the time of calculation. Since these calculations are performed at different times, the underlying information may change. WPP St. 1 at 17.

Capacity rates are normally paid to QFs on a cents per Kwh basis for Kwh's of energy which are scheduled and delivered. This provides a strong incentive for the QF to maximize its availability and deliveries. Under dispatch conditions the QF is paid a capacity rate for the amount of capacity which is available and scheduled for possible delivery. Under certain conditions of poor performance, such as excessive deliveries during off-peak hours and inability to meet dispatch criteria, the capacity payments to the QF are reduced. WPP St. 1 at 17.

As noted above, WPP maintains that the EEPA rates are below its avoided costs under either its methodology or the Commission's regulations. No party challenged WPP's methodology or the calculated energy rate in the EEPAs.

At issue are the correctness of the inputs WPP used in its methodology regarding the capacity rate calculation. These inputs include the reserve margin, the type of avoided unit used (coal v. combustion turbine), the avoided unit's availability, and the fixed charge rate.

Also at issue is WPPII's assertion that WPP's capacity rates should be based on the renovated Springdale and Mitchell plants which will come on line before any of the QFs. In addition, OCA argues in favor of a correction to the Milesburg Project avoided capacity costs to reflect monthly payments required by the EEPA. Finally, AAL and WPPII argue for EEPA capacity rates to be passed through to WPP's ratepayers on a demand/energy basis instead of on an energy basis only. These issues are addressed below.

2. *Reserve Margin*

A reserve margin is the percentage by which a utility's firm energy resources exceed peak hour customer demand. OCA St. 1 at 21. WPP is part of the integrated APS system. Generation planning for the system is done on a centralized integrated basis. During 1985 and 1986, and at present, APS has defined its criterion for reserve margin as follows:

> No more than forty to sixty days DSCR (Dependence on Supplemental Capacity Resources) for APS; and a minimum of 25 percent installed reserves at time of winter peak.

WPP Ex. 16 at tab 5 (WPP St. 9 in R-850220, upon Reconsideration, at 16); Tr. 1001.

The APS generation plan dated May 1, 1986 uses a 25% minimum reserve margin criterion and provides for three coal units of 300 Mw each which will come in service in October 1995, 1997, and 1998, respectively. WPP Ex. 8. These are the planned units which were used to compute the avoided capacity rates for the EEPAs in question. WPP St. 1 at 15-16, 20, 22, and 23.

AAL witness Falkenberg would revise the APS reserve margin criterion to 15 percent. AAL St. 3 at 16, 20, 30, and 35. OCA witness Biewald would revise the APS reserve margin criterion to 20 percent. OCA St. 1 at 35.

During its direct case, WPP relied on testimony and exhibits from three previous Commission proceedings which considered an appropriate reserve margin for WPP in conjunction with the Bath County Pumped-Storage Hydroelectricity Facility (Bath County). On November 30, 1984, WPP filed for a rate increase at Docket No. R-842632. *Pennsylvania Public Utility Commission v. West Penn Power*, 59 Pa PUC 552, 69 PUR 4th 470 (August 28, 1985). In large part, the proposed increase reflected the purchased power costs of Bath County.

WPP has included in its Ex. 16 in this case the testimony at Docket No. R-842632 of J. W. Geiser, Vice President of Planning for APS; and Homer T. McCarthy, Director, Generation Planning (now retired). WPP Ex. 16 at tabs 1, 2 and 3. Mr. Geiser's testimony contains a general description of the reserve margin criterion of APS. WPP Ex. 16 at tab 2 (WPP St. 11 in R-842632 at 11-12). Mr. McCarthy's testimony came in rebuttal during which he refuted the testimony of three experts: Messrs. Gerasimou, Falkenberg, and Baron. Among the arguments that Mr. McCarthy refuted was the claim of Mr. Gerasimou that because of APS' many transmission lines interconnecting with other utilities, it had ready access to capacity or energy during times of emergencies. WPP Ex. 16 at tab 3 (WPP St. 15 in R-842632 at 9-11).

The Commission did not approve recovery of the Bath County costs at R-842632 because the plant did not come on line during the future test year. On October 18, 1985, at Docket No. R-850220, WPP filed its second rate case generally relating to the recovery of the cost of purchased power from Bath County. *Pennsylvania Public Utility Commission v. West Penn Power*, 61 Pa PUC 711, 77 PUR 4th 220 (July 24, 1986). In the proceeding at Docket No. R-850220, the ALJ refused to reconsider the question of reserve margin criterion, and struck the testimony, *inter alia*, of Messrs. Falkenberg and Baron. This decision was affirmed by the Commission. 61 Pa PUC at 727-731, 77 PUR 4th at 236-239.

The Commission granted a petition to reopen the record and a petition for reconsideration to consider the effect of Section 1323 (signed into law on July 10, 1986) which deals with excess capacity. This resulted in another hearing (R-850220 Reconsideration) on the subject of the APS reserve margin criterion. WPP has included in its Ex. 16 testimony by Homer T. McCarthy; J. Robert Kissner, Manager, Load Forecasts; Albert F.

Kave, Jr.; J. F. Hose, Manager, Load Modification Program Planning; Kenneth J. Blasko, Manager, System Operations Engineering; and James E. Susman, Vice President of Energy Management Associates, Inc. WPP Ex. 16 at tabs 6-10.

As WPP notes (WPP M.B. at 15-16), the hearings at Docket Nos. R-842632, R-850220, and R-850220 Reconsideration covered the same period (1985 and 1986) relevant to these proceedings. As a result, the question of the APS reserve margin has been the subject of three sets of hearings and two pertinent commission orders. WPP emphasizes the direct testimony of Homer McCarthy offered in September 1987 at Docket No. R-850220 Reconsideration. WPP Ex. 16 at tab 5 (WPP St. 9 in R-850220 Reconsideration). The first 21 pages of his testimony together with supporting exhibits contain a summary of the history of the development of the APS reserve margin criterion; the reasons for its adoption; its continued use by APS; and the use of the reserve margin in APS generation planning.

OCA criticizes this Bath County testimony as not concerning the planning reserve margin required *after* Bath County became a generating resource to APS. OCA M.B. at 20. OCA witness Biewald concludes that the WPP planning reserve margin should be no more than 20%. OCA St. 1 at 18-48.

Using WPP's dates for agreement in principle on rates, Mr. Biewald's analysis was done from the perspective of 1986 using the same method APS used in 1983 when APS last did a reliability analysis of its system. Mr. Biewald checked his analysis by referring to reliability goals set by the East Central Area Reliability Coordination Agreement (ECAR), of which WPP is a member, and other reliability councils. He used current generating unit unavailability data as of 1986, whereas WPP's last use of the program in 1983 used average unavailability data for the years 1976 through 1982. OCA St. 1 at

38-39. Using the updated unavailability data produces an average unit unavailability of 23.8% (as opposed to WPP's 27.4%). Applying this to the APS 1983 capacity reserve margin study produces a reserve margin of 16% to 20%. OCA St. 1 at 40-41; OCA St. 1 at Sch. BB-7.

The use of OCA's 20% reserve margin rather than WPP's 25% planning reserve margin delays the date when additional generating capacity is required to be brought on line by APS. An additional generating unit for APS would not be required in 1995, as projected by APS in 1986, but rather in 1998. The resulting capacity rate reduction from this change for Milesburg [18] would be from 3.12¢/Kwh to 2.45¢/Kwh, for Burgettstown from 3.73¢/Kwh to 2.98¢/Kwh and for Shannopin from 4.08¢/Kwh to 3.24¢/Kwh. OCA St. 1 at 48-49; OCA St. 1 at Sch. BB-11.

AAL attacks the studies supporting the APS reserve margin as outdated. AAL M.B. at 61-66. These studies are the 1981 General Electric over/under societal cost study, the 1984 EMA societal cost study, and the 1983 Capacity Margin Program probabilistic reserve margin analysis. Tr. 1001. OCA's attack on the EMA study appears at OCA M.B. at 38-39.

AAL witness Falkenberg concludes that in the 1986-87 time period APS could have achieved its reliability criteria of 40-60 DSCR with a 15% reserve margin. AAL St. 3 at 26; AAL Ex. 70. He performed a reliability analysis and compared it to the 1987 APS PROMOD III study. AAL St. 3; AAL Ex. 69. After determining that his model was similar to the APS model, he determined the DSCR levels resulting at various APS reserve margins. AAL St. 3 at 26, AAL Ex. 70; Tr. 1288. He then reaches the above conclusion: 40-60 DSCR at reserves of 15%. Mr. Falkenberg also updated the 1981 and

---

[18] The initial rate for Milesburg represents a corrected calculation to represent monthly EEPA payments. See Section I D 7 below.

1983 APS Capacity Margin Programs to account for improved generating unit availability, resulting in a 25% unavailability figure which translates to a reserve margin of 17% to 22% at 40-60 DSCR. AAL St. 3 at 33.

AAL supports Mr. Falkenberg's recommendation by arguing that it is consistent with planning reserve margins used by other utilities. *See* AAL M.B. at 70-72. AAL also asserts that a periodic updating of the APS planning reserve margin criteria is essential. In support, it points to a 1983 Commission mandated management audit of WPP recommending two year updates and criticizes APS for not updating its study before committing ratepayers to about $548,000,000 in additional capital expenditures resulting in a $52,557,121 annual rate increase (for all projects except Monongahela). AAL M.B. 72-77.

The Projects presented two witnesses who testified in favor of WPP's reserve margin requirement. In general, the Projects maintain that WPP's methodology conforms to standard industry practices widely accepted by regulatory commissions, that WPP's load forecasting technics result in competent forecasts, and that WPP needs a 25% planning reserve margin because it has an unusually large number of supercritical generating units and because WPP has a higher load factor than most other electric utilities. BM&S M.B. at 46-48.

In his rebuttal testimony WPP witness McCarthy reiterated the factors he considered when recommending to senior APS management the reserve criterion he used. He took into account the following factors:

1. The size of the system and size of the units within the system, particularly the fact that APS had ten super-critical units which ranged from 540Mw to 640Mw, each of which is about 10% of the APS system peak load. Tr. 859.

2. APS' high load factor. APS normally has one of the 10 highest load factors of the top 100 investor-owned utilities in the country. Tr. 860-861.

3. The availability of the units, including the improvement in availability in recent years. Mr. McCarthy rebutted the great significance placed on this improvement by Messrs. Falkenberg and Biewald by expressing concern that this level of availability may not continue for the following reasons: (a) the improvement may be in part due to temporarily higher operating reserves that allow lower levels of stress on individual units, (b) the equipment is aging, (c) extreme weather can result in availability problems, and (d) environmental factors such as possible acid rain legislation could significantly decrease availability. Tr. 861-65.

4. The continued doubt as to the actual availability of the PURPA projects over the terms of their contracts. Tr. 867.

5. The availability of power from other companies in the ECAR region. Although recognizing that APS had fairly high interconnection capabilities, Mr. McCarthy does not rely heavily on this factor because extreme weather conditions normally extend over a large portion of the region so all utilities in the region tend to be in need of power at the same time. Tr. 871-72.

6. The APS difficulty in maintaining adequate power supply during a period of very severe weather. As an example, Mr. McCarthy cited the winter peak of January 21, 1985, when power was not available from other companies in the ECAR region. Tr. 873.

In addition to these factors, Mr. McCarthy relies on experience and judgment to determine an appropriate reserve margin. He testified about this as follows:

> Q. Now, in reaching your judgment as to the appropriate level of reserves, are you—is the means by which you reached this judgment the computation of this 40 to 60 days per year dependence on supplemental capacity resources? In other words, my question, do you use a formula of some kind to reach this judgment, a final judgment of 25 percent?
>
> A. Do I use a formula?
>
> Q. A formula.
>
> A. No. Not necessarily a formula, no.
>
> Q. Would it be fair to say that you use a range of factors that you take into consideration?
>
> A. Yes. I think I—you know, I've been pointing out that many things go into the determination of what would be the appropriate reserve margin. Certainly, these—these studies, such as a capacity margin analysis, studies like what is termed over, undercapacity which indicates what the lowest cost to the customer would be at a certain reserve margin, these are tools that are used. But in addition to those, I apply experience and judgment from my years working with the company.

Tr. 880-81. *See also* testimony of David Nevius, Tr. 1214-1215.

Mr. McCarthy offered the following in response to being criticized for not performing a new formal study on the reserve margin criterion in 1986.

> While we had no formal study, we are continuously looking at all of the factors that would go into the determinations of a reserve margin, which we talked about today, all of these various factors, and what the situation would be, the uncertainties of the future, the uncertainties of forecasts, the weather sensi-

> tivity, what availabilities may be in the future, and what may occur with acid rain, and a host of other things and it was our judgment that 25—minimum 25 percent reserve margin was appropriate.

Tr. 877-878. Also, Mr. McCarthy testified that he and the other eight persons in the generation planning group devoted a significant part of their time in 1986 to the reserve margin criterion question. Tr. 878-79.

WPP successfully rebutted OCA's and AAL's argument that Mr. McCarthy's recommended planning reserve margin is out of line with other utilities and with the recommendations of the North American Electric Reliability Council (NERC) and its various regional councils, particularly ECAR. WPP Exhibit 17 and the testimony at transcript pages 720-727 show that a 25% reserve margin is not out of line with the industry throughout the United States and in ECAR. See WPP M.B. at 22-23. Also, I accept the testimony of David R. Nevius, Vice President of NERC, that there is no national norm of a 15% to 20% reserve margin criterion, as advanced by Mr. Falkenberg, and that there is not a usual assumption that a large, interconnected system has a reserve margin of 15% to 20%, as advanced by Mr. Biewald. Tr. 1211-12, 1215-16. Mr. McCarthy testified that other large, well-interconnected power systems have planning reserve margins of at least 25%. Penn Power (part of Ohio Edison) has a planning reserve margin of 25%, Philadelphia Electric at least 25%, and both Metropolitan Edison and Pennsylvania Electric (part of General Public Utilities) have planning reserve margins of 26%. Tr. 888. It is also Mr. McCarthy's understanding that the PJM pool is going to increase its reserve margin obligations from 22% to 25%. Tr. 889.

WPP Exhibit 17, the testimony of Nevius, and WPP Exhibit 19, the testimony regarding the reserve margins of other Pennsylvania utilities, demonstrate that the re-

serve margin criterion of WPP is not out of line with the industry.

WPP attacks Mr. Falkenberg's model, which changed between 1987 (when he focused on Loss of Load Probability (LOLP)) and 1989 (where he uses DSCR), because he did not disclose the nature of the changes. WPP also notes that Mr. Falkenberg did not submit data about his two models to parties requesting it. Tr. 1312-15. In addition, the model has not been used by any electric utility. AAL St. 1 at 4; AAL Ex. 63. For these reasons, and because it uses a time frame which I reject, *see* Section III C above, I give no weight to Mr. Falkenberg's 1989 model results.

OCA and AAL attack the factors considered by Mr. McCarthy at Tr. 861-65, referenced above. They are discussed below.

a. *High Load Factors and Super-Critical Generating Units*

OCA argues that if a properly determined probabilistic model is used to calculate an appropriate reserve margin, it is unnecessary to change the result to account for load and resource values already embedded in the model. OCA M.B. at 33-37. AAL witness Falkenberg, testifying in support of his probabilistic reserve margin, stated that any such program would take these factors (high load factor, super-critical units) into account. Tr. 1309-10.

Mr. McCarthy, Mr. Schultz and Mr. Depenbrock testified that the high load factors on the APS system support the proposed 25% reserve margin. Tr. 860; MEI St. 2 at 11; B&S St. 1 at 8-9.

Mr. McCarthy and Mr. Schultz also testified that the existence of super-critical coal generating stations on the APS system supports the APS proposed reserve margin of 25%. Tr. 860, MEI St. 2 at 10-11.

OCA has not demonstrated its argument with evidence and I have rejected Mr. Falkenberg's study for reasons given above. WPP has demonstrated that its high-load factors and super-critical generating units support its 25% reserve margin.

b. *Generating Unit Availability*

OCA asserts that Mr. McCarthy used the worst seven years of unit availability data for the 17 year period before 1986. It adds that using availability data for the entire period 1970 through 1986 produces a planning reserve margin of about 18% to 23%. Tr. 974-75. According to OCA, WPP has not supported its outdated use of relatively high unit unavailability rates given the range of rates experienced on the APS system during any period considered reasonable. OCA adds that much of the availability data WPP used predates Bath County, the inclusion of which in 1985 was expected to increase system reliability. AAL argues that the APS use of outdated unavailability data renders the 1983 capacity Margin Program an inappropriate tool upon which to base the calculation of capacity rates. AAL M.B. at 66.

I am satisfied, however, that Mr. McCarthy gave due consideration to the recent improvement in unit availability. In my opinion, in the use of his experience and judgment, Mr. McCarthy did not overstate WPP's reserve requirements for the reasons given during his cross-examination by OCA at Tr. 861-865. He believed that unit availability could decline as capacity margins decline and generating units are fired harder. Tr. 862-63. Lower reserves may result in less maintenance. Tr. 863. APS generating units were aging. Tr. 863. Acid rain legislation could be enacted. Tr. 865. All of these can reduce unit availability and Mr. McCarthy used correct judgment in 1986 that the planning reserve margin should not be changed in response to a then recent improvement in generation availability.

c. *Acid Rain Legislation*

Besides Mr. McCarthy (Tr. 865, 991), MEI witness Schultz (Tr. 507, 1135) posited that pending acid rain legislation may require that additional generation units be built or that existing units be retired. OCA calls this reliance highly speculative and, noting that WPP would not apply the then impending TRA-86, argues that WPP should not be permitted to freely speculate on potential legislation as it chooses. OCA M.B. at 28-29.

There is a difference between TRA-86 and acid rain legislation as they pertain to these proceedings. WPP was correct in not incorporating TRA-86 because it was not enacted during the time of serious negotiations. This time frame is an objective guideline to give consistency to utility/QF negotiations as discussed fully in Section III C above. Whether or not to give weight to pending acid rain legislation in evaluating unit availability, however, is a subjective determination requiring judgment. It is no secret that the utility industry is concerned about acid rain legislation. Although such legislation might allow older generation units to remain in operation (Tr. 992), it could also have the opposite effect. Regardless of this, WPP used correct judgment in considering acid rain legislation as one of several reasons why current availability data might not hold in the future.

d. *Recommendation*

In ruling on the reserve margin question at R-842632 the Commission stated:

> In sum, Mr. Falkenberg recommended a reserve margin of 20%, and Mr. Gerasimou recommended a range of 16% to 19%. However, there is no magic number which applies to all utilities at all times. For example, in refusing to make an excess capacity adjustment for Pennsylvania Power Company, which had a reserve of 32.6%, we recently stated:

> "The OCA has presented testimony and extensive argument in support of its recommended 20% reserve generating capacity which it characterizes as being an acceptable standard or benchmark in the electric generating industry. This commission, as early as 1972, urged a reserve capacity of at least 20% in *Pennsylvania Pub. Utility Commission v. Duquesne Light Co.*, 46 Pa. PUC 427, 437, 438, 97 PUR 3d 227, 232 (1972), in order '[T]o cover peak loads, scheduled maintenance, and forced outages in order to avoid blackouts, load curtailments, and voltage reductions.' We do not believe, however, that a capacity reserve margin of 20% or any other specific percentage could or should apply as an industry standard. *An acceptable reserve generating capacity margin for any particular electric utility is dependent upon the generation mix, availability of generating units, peak-load requirements, the period during which the peaking capacity is required, rates of forced outages, transmission capabilities, interconnections with other utilities and transfers of energy during emergency. These are some of the operating factors which must be considered when reaching a determination concerning an acceptable generating reserve margin.*" *(Pennsylvania Pub. Utility Commission v. Pennsylvania Power Co.*, 58 Pa PUC 305, 314, 60 PUR 4th 593, 601, 602 (1984).
>
> The company in this case has presented substantial evidence that, under its particular circumstances, a reserve margin as high as 31% is appropriate, and we accept that judgment. (emphasis added)

59 Pa PUC at 573, 69 PUR 4th at 488. Although the Commission did not approve recovery of Bath County at R-842632, the above discussion is relevant here.

Forecasting a reserve margin requires the use of studies and computer analyses, but the final decision requires

informed judgment based upon experience. WPP produced witnesses and exhibits showing that the studies available when the 25% reserve margin decision was made, and the APS informed judgment based on experience related to events occurring between the time of the studies and the time of the decision, support the APS planning reserve margin which was used to set the avoided costs in these proceedings. I recommend that the Commission accept the APS studies and judgment and approve of the 25% planning reserve margin.

3. *Coal Unit v. Combustion Turbine*

In 1986, WPP projected that the next generating unit which it would construct would be a series of three 300 Mw coal units, the first of which would be brought on line in 1995. These projected avoided units served as the basis for setting the capacity rates for the Milesburg, Burgettstown and Shannopin projects. WPP St. 1 at 22-24. OCA witness Biewald determined that APS erred in planning to build three coal units as its next capacity resource. OCA St. 1 at 50-67. The OCA argues that in 1986 the APS system should have planned to construct oil or gas fired combustion turbines (CTs) to provide peaking capacity before constructing additional coal units. OCA St. 1 at 50.

In its generating mix a utility utilizes both base load plants, which generally offer high capital costs but lower fuel costs, and peaking plants, which offer lower capital costs but higher fuel costs. A mix of these resources economically meets the load of a utility system. A base load plant economically serves constant load which requires their use at a fairly constant level or at a high capacity factor. However, a base load plant cannot economically serve fluctuating peak load. A peaking plant, such as a CT, which will operate intermittently as peak load rises or falls, can most economically serve load which requires operation at a fairly low capacity factor. Thus,

while a peaking unit could not economically serve customer load at a high capacity factor, its operation is far more economic than that of a base load unit when serving incremental peak load. OCA St. 1 at 51; Sch. BB-4 at 4.

Mr. Biewald analyzed the APS system and concludes that it has been and was projected to be overly dependent upon base load capacity. From a fuel diversity perspective APS was also heavily dependent upon coal fired generation. Additional peaking generating resources fueled by oil or gas would have represented a preferable mix of fuel sources and would have increased fuel diversity on the APS system. Mr. Biewald recommends, therefore, that a CT unit, not a coal unit, should be used as the unit to be avoided by the QF capacity under consideration here. He adds that the net effect of adding a 300 Mw coal unit in 1995 would be to increase system operating costs. OCA St. 1.

OCA also criticizes the APS 1986 plans for a baseload coal unit because no formal study was done in 1986. OCA St. 1 at 54-56. Mr. Biewald contends that if such a study had been done, it would have shown a need on the APS system for more peaking capacity before any additional baseload because fuel oil prices had decreased. OCA St. 1 at 57.

OCA also attacks two studies completed by Mr. Geiser in 1984. They are studies upon which, according to Mr. McCarthy, APS relied to support the selection of a base load plant over a CT. OCA M.B. at 47-52. OCA claims that it is incorrect to use the dependent forced outages assumption in the second Geiser study (use of average forced outage rates in the first Geiser study produced results favorable to a CT). The dependent forced outage rate is designed to reflect the dependence of outage rates related to cold weather. Tr. 1701-02. Mr. McCarthy used the three highest monthly forced outage rates throughout the year, regardless of when they occurred, and assigned

these rates to the winter period in the APS production cost model. Tr. 1701. Thus, the dependent forced outage rates assigned to the period of the APS' winter peak were 2.33 times the average of the non-winter outage rates during the 1982-1986 period. Tr. 1697-1700. The actual winter outage rates were 11.5% for this period and 9.6% for the non-winter period. Tr. 1706-07. This reflects a much smaller outage difference than that used in the APS dependent forced outage rates. OCA argues that APS has misapplied the three highest monthly outage rates experienced on its system to the winter months as these high outage rates often occurred in non-winter months. Tr. 1702-03.

The OCA submits that APS could have but did not conduct a study to determine representative outage rates during the winter and non-winter months and then apply these rates in its production cost studies to the winter and non-winter periods. According to OCA, the results of the second Geiser study, and any other APS studies using dependent forced outage rates, cannot be relied upon to accurately project system cost results.

OCA also maintains that had APS done an accurate study in 1984 it would have had to be updated in 1986 to consider the change in oil prices occurring between 1984 and 1986. Doing so would have resulted in CTs being the preferable generating resource. OCA St. 1 at 57.

In response to OCA, WPP relies on Mr. McCarthy's testimony at Tr. 881-86 and 922-24. In developing the 1986 generation plan, Mr. McCarthy evaluated the possibility of adding combustion turbine capacity. Tr. 881-886. He considered the analysis done in 1984 which had indicated that the cost of combustion turbines was higher than the 300 Mw coal units. McCarthy explained that in the fall of 1985, when the 1986 generation plan was being developed, oil prices were just starting to decline, and APS had no assurance about what these prices would

be in the future. Tr. 882-84, 922. McCarthy also considered the availability of economical supplies of coal (Tr. 923) and the national and state policies of encouraging the use of coal, the Power Plant and Industrial Fuel Use Act of 1978 (Fuel Use Act). Tr. 881-82. Finally, McCarthy explained that APS' high load factor, approaching 90% daily, requires more baseload capacity because the equipment has to be loaded over long peaks. Tr. 923.

OCA counters that the Fuel Use Act provides for exemptions for peakload powerplants and that WPP acknowledges that CTs would be used as peakload plants. OCA M.B. at 52-56; Tr. 56, 946. Even so, Mr. McCarthy did not investigate constructing a CT under the Fuel Use Act exemption. Tr. 942-43. Also, other ECAR companies intended to bring CTs on line in 1992-1996. Tr. 854, 986; WPP Ex. 17.

OCA also disagrees with Mr. McCarthy's testimony about oil and gas prices. OCA submits that oil prices began to decline dramatically in 1985, and dropped quite low in 1986, but that Mr. McCarhty made no attempt to change the APS plans to build a coal unit. OCA St. 1 at Sch. BB-12. Also, Mr. McCarthy did not investigate the possibility of purchasing natural gas from producers or pipelines and transporting that gas to an APS generating facility for use in a CT. Tr. 987-88.

OCA argues against Mr. McCarthy's use of WPP's high load factor as a reason not to select a CT. It relies on testimony that APS CTs operate at low load factors. Tr. 938-39.

The Projects witness Mr. Ross criticized Mr. Biewald's method of calculation because:

> In order to properly evaluate the total cost of the resources, you must look at the life cycle. Otherwise, you will always choose a low capital cost, high operating cost resources, which may, and usually is, not the least cost resource.

Tr. 1183. The Projects maintain that by assuming that the oil-fired unit would be deferred for seven years, Mr. Biewald eliminated the need to compare operating costs for the entire 33 year life of the unit. This makes Mr. Biewald's method of comparing coal fired units to combustion turbine units weighted in favor of the unit with the lowest construction cost and the highest operating cost.

The Projects conclude that Mr. Biewald chose a methodology and assumptions that were calculated to give him the result he sought. He should have chosen a methodology and a set of assumptions which would provide a non-biased planner an opportunity to review the options on the basis of the costs over the entire period in which the avoided unit was to be used instead of just an arbitrary and hypothetical period between the installation dates of the two hypothetical units. Tr. 1193-1197; BM&S M.B. at 55-56.

OCA responds by pointing out that Mr. Ross did not submit a life cycle analysis and only supposes that the results would contravene Mr. Biewald's conclusions. As parties supporting the position of WPP, OCA argues that the Projects have the burden of proof and that this requires them to produce an analysis to refute Mr. Biewald's testimony. OCA concludes that the Projects failed to meet the burden of proof by failing to submit comparative cost analysis.

It should be noted that the OCA calculated its capacity cost using CTs by deferring the three 300 Mw coal units, the first of which was scheduled by APS to go on line in 1993, with 832 Mw of CTs. The use of 832 Mw of CTs was based upon WPP's own *1988* Resource Plan as filed with the PUC. OCA St. 1 at 56, 59. This usage of CTs was employed by Mr. Biewald as it represents the results of the first APS study done since 1984 in order to determine what its next generating resource should be. The use of 832 Mw of capacity

is derived from the WPP *1988* Resource Plan which recognized that under the best available projection of oil prices more than 832 Mw of peaking capacity was justified on the APS system. Tr. 836. The APS 1988 recommended addition of 832 Mw of CT capacity was based upon a high forecast of oil prices. Tr. 836.

Using a 25% reserve margin and 832 Mw of CTs results in deferring the first of the three coal plants from 1995 to 2002. Using a 20% reserve margin and 832 Mw of CTs results in deferring the first of the three coal plants from 1988 to 2006. OCA St. 1 at 60. In calculating the present value of future capacity on the APS system, Mr. Biewald reflected the lower capital costs of the CTs, being the first avoided generating units, and also the cost of the later avoided coal units as discounted to present value. OCA St. 1 at 60. While he defers the APS avoided coal unit from 1995 to a later date, he reflects the discounted cost of the avoided coal unit when it later reappears in the OCA generation forecast. In addition, Mr. Biewald has recognized the energy cost benefits associated with the QFs here at issue.

In Mr. Biewald's 25% reserve margin case, the recommended capacity rates based upon the use of CTs before bringing on line base load capacity changes from 3.12¢/Kwh to 2.02¢/Kwh for Milesburg, 3.60¢/Kwh to 2.50¢/Kwh for Burgettstown and 4.00¢/Kwh to 2.69¢/Kwh for Shannopin. In the 20% reserve margin case the recommended capacity rates based upon the same generating unit assumptions are 1.68¢/Kwh for Milesburg, 2.13¢/Kwh for Burgettstown and 2.28¢/Kwh for Shannopin. OCA St. 1 at 64.

The Commission's regulations, 52 Pa. Code § 57.34 (c)(4)(iii), define the proxy unit to be used in avoided cost calculations as follows:

> *System Reliability.* If a utility anticipates inadequate system reliability as a result of not being committed to sufficient plant during any period over the

next ten years, then the estimated construction costs of a new coal plant will be used as a proxy.

The criteria for commitment state that "[a] utility is considered to be committed to a plant if any of the following criteria are met: (A) The utility has spent 10% or more of the total estimated cost of construction or implementation; (B) The plant is due on line within 8 years, if a base load plant, or 5 years, if not a base load plant; [or] (C) Contracts have been signed for significant components of the plant." 52 Pa. Code § 57.34(c)(4)(i). WPP argues that at the appropriate time, WPP did anticipate inadequate system reliabiilty (i.e., a lower than adequate planning reserve) in the next ten years. But because at the appropriate time WPP did not plan to construct any non-base load plant which would come on line within five years nor any base load plant on line within eight years, and because WPP had no signed contracts for significant components of a new plant, WPP was not committed to a plant within the meaning of the regulations. WPP concludes that Section 57.34(c)(4)(iii) applies and the proxy plant is to be a new coal plant. *See also* WPP R.B. at 14-16. OCA interprets this Section differently. OCA M.B. at 18-26. A lengthy discussion of this is unnecessary because I conclude that under its methodology, WPP correctly selected a coal unit.

APS made its decision to use a coal-fired unit when the APS Generation Plan, dated May 1, 1986 was being formed. WPP argues that at that time, Mr. McCarthy took into consideration the many years of satisfactory service to APS and its ratepayers of coal-fired units (there is no record evidence of this); the drastic escalation in the price of oil and gas, even though tempered by a drop in such prices in late 1985 and early 1986; the results of studies which at best showed only a minor financial advantage for combustion turbines; the technological limitation on combustion turbines at that time;

and public policies and laws designed to encourage the use of coal. WPP aserts that all of this provided substantial evidence in support of Mr. McCarthy's decision to use a coal-fired unit as the capacity to be added in 1995. WPP R.B. at 13.

Although OCA's criticisms of the APS decision have some merit, they do not invalidate the experience and informed judgment of Mr. McCarthy. I conclude that WPP has submitted substantial evidence to support the APS decision in 1986 that a coal unit would be required in October 1995.

4. *Mitchell and Springdale Units*

WPPII argues that WPP's true avoidable resources is the renovated Springdale and Mitchell generating units, not three 300 Mw coal fired generating units. WPPII M.B. at 13-20. On April 11, 1983, West Penn filed a petition (Docketed at P-830434) with the Commission requesting permission to discontinue operations at the Springdale Power Station and Units 1 & 2 of its Mitchell Power Station. By Order of May 13, 1983, the Commission permitted West Penn to temporarily deactivate and place in cold reserve Springdale and Mitchell. By order of August 19, 1983, Springdale and Mitchell were placed in cold reserve and removed from West Penn's rate base. In the Bath County litigation it was determined that the 361 Mw associated with the Springdale and Mitchell units were not to be considered installed capacity for the purpose of evaluating whether the Bath County pumped storage project was excess capacity. Order dated August 28, 1985 at Docket No. R-842632 at 45-46; WPP Ex. 15, Vol. I, Tab 5 at 20-21.

WPPII turns to the Commission's regulations which defines the plant to which the utility is committed as generating equipment, purchase power agreements, load management programs, or any other programs designed to meet the capacity needs of a utility. 52 Pa. Code

§ 57.34(c)(3). Next, WPPII notes that neither the Commission's regulations nor the FERC PURPA regulations require that the calculation of avoided cost or the EEPA capacity rates be based upon the costs associated with the construction of *new* generating capacity. WPPII asserts that although the Springdale and Mitchell units are existing units in the physical sense they are not available to serve customer demand and APS and West Penn must expend over $71 million to return the units to active service. Tr. 310, 314; WPPII Exs. 1-7.

Applying the criteria in 52 Pa. Code § 57.34(c)(4) (set forth in Section III D 3 above), WPPII argues that as of 1986 neither APS nor WPP was committed to the three 300 Mw units for the following reasons:

> As of 1986 APS and WPP had not spent 10% or more of the total $2.5 billion estimated cost of construction of the three 300 Mw hypothetical coal units. Tr. 43.
>
> APS and WPP have spent only $11 million toward the construction of these units. Tr. 42.
>
> In 1986 APS and WPP planned to construct and bring the three 300 Mw units in 1995, 1997 and 1998 respectively. Tr. 48.
>
> The first of the three 300 Mw coal plants was due on line in 1995 or within nine years; rather than eight year on-line criteria set forth in the Commission's regulations. Tr. 48.
>
> Neither WPP nor APS have let any contracts for the significant components of the plant. Neither WPP nor APS have let contracts for building the units or buying the generation equipment. APS and WPP have only retained UE & C to complete design work and prepare cost estimates. Tr. 43.

WPPII then applies the above referenced criteria to Springdale and Mitchell. In 1986 the renovation and

reactivation of Springdale and Mitchell was scheduled for 1992 and 1993 respectively. Tr. 313. In 1986, when the rates at issue were calculated, Springdale and Mitchell were due on line within seven years, or well within the eight year period specified by the Commission's regulations. Accordingly, APS and WPP were committed to the Springdale and Mitchell renovation and reactivation rather than to construction of the three 300 Mw units. According to WPPII, its conclusion is supported by the APS and WPP integrated resource plans, not the subjective opinion of an expert witness. WPPII M.B. at 18; WPPII Exs. 1-6.

WP witness Mr. Kave testified that WPP's generation plans indicate that the Springdale and Mitchell reactivation was always delayed until after PURPA projects came into service because the addition of PURPA capacity benefited ratepayers by delaying the costs of reactivation from as early as 1990 and 1991 to 1997 and 1998. Tr. 324. To this, WPPII responds that WPP ratepayers only truly experience the benefit of deferral of the reactivation costs of Springdale and Mitchell if the EEPA capacity rates are properly calculated based upon the $71 million renovation costs, not the $2.5 billion costs of the three 300 Mw coal units.

WPP also argues that WPPII's position is inconsistent with 52 Pa. Code § 57.34(c)(4)(iii), discussed in the previous section. WPP claims that the Generation Capacity Plan in effect at the time of the agreements in principle on rates in 1986 shows that WPP would need additional plant by 1995, *despite* the planned reactivation of the Mitchell units in 1992 and the Springdale units in 1993. WPPII Exs. 4 and 5. WPP concludes that in 1986, WPP was faced with inadequate system reliability within ten years, and it properly used the coal plant as a proxy. WPP Reply Brief (R.B.) at 16-17.

WPP also argues that WPPII's position is inconsistent with 52 Pa. Code § 57.34(c)(4)(i), which provides that

a utility is committed to a plant for avoided cost calculation purposes if it is a baseload plant which is due on line within 8 years or if it is a non-baseload plant which is due on line within 5 years. The Mitchell and Springdale units are oil-fired peaking units, which would only be used when WPP's coal-fired baseload plants are unable to handle the system load. WPP Ex. 16 at Tab 5 (WPP St. 9 in Docket No. R-850220 Reconsideration at 20-21; McCarthy testimony in Docket No. R-850220 Reconsideration, Tr. 1681). Because Springdale and Mitchell are non-baseload plants, and because in 1986 they were not "committed" units under the regulations, they were therefore properly not used as the proxy in WPP's avoided cost calculations. WPP R.B. at 17.

I agree with WPP's application of the facts in these proceedings to 52 Pa. Code § 57.34(c)(4)(i) and (iii). For these reasons, selection of the Mitchell and Springdale units is not mandated here. I do not conclude, as does WPP, that the regulations require the use of costs associated only with a new plant. WPP R.B. at 17-18. Under facts different than those presented here, the Commission might conclude that a plant in cold reserve must be used to calculate avoided costs.

5. Fixed Charge Rate

WPP uses a levelized annual fixed charge rate (FCR) to estimate the cost of owning capital assets. It is expressed as an annual percentage, effective for the life of the asset, and applied to the estimated original investment in the asset. In this case, the asset is the estimated original investment in the avoided facilities. The principal elements of the FCR are the cost of capital, depreciation, income taxes, insurance, and property-related taxes.

An FCR enables an engineer or analyst to make a comparison of the present worth of alternative courses of action without going through a detailed, year by year revenue requirement calculation. Tr. 1036. FCRs are

used throughout the APS system in all of the operating companies to do various engineering studies, *e.g.*, to determine the choice of energy supply equipment, and to determine whether to install new equipment or incur additional operation and maintenance expense. Tr. 1037. APS revises FCRs whenever conditions warrant; most revisions occur when the forecast of the future cost of capital is revised. Tr. 1037.

WPP used an FCR of 17.7% for all three Projects. AAL argues in favor of an FCR of 13.88% for the MEI Project and 14.65% for the Burgettstown and Shannopin Projects.

a. *Cost of Capital*

APS used the same cost of capital in the FCR that it uses throughout the APS system for economic studies. Tr. 1320-21. APS did cost of capital analyses for short-term and long-term projections. Tr. 1329. The cost of capital used by APS in the FCR for the avoided cost calculations at issue was a long-term projection. AAL Ex. 78. AAL witness Davila recalculated the cost of capital used by APS in the FCR, using a different capital structure, a different bond rate, a different cost of preferred stock, and a different cost of common stock. AAL St. 1 at 8-12. The major difference between WPP's determination of the cost of capital to be used in the FCR and Mr. Davila's approach is that WPP forecasts cost of capital, while Mr. Davila uses historical data. Tr. 615.

A treatise (by Robert Hahne and Gregory Aliff of Deloitte Haskins & Sells) on accounting for public utilities, which Mr. Davila attached to his prefiled testimony, AAL St. 1 at 7, recognizes the problems inherent in using historical data:

> The idea that historic data express factual conditions has sometimes led to the conclusion that those data are the most reliable data available for estimating

> future conditions. The factual nature of the events as recorded has apparently imbued the data with a degree of soundness and quality that appears to exceed a forecast approach for test year purposes. When conditions are in a state of change, historic data are likely to be the most unreliable in measuring test period conditions as a basis for future rate needs. While projected data using standard forecasting techniques may miss the mark, historic data, with a patchwork of updating, will surely miss the mark. As imprecise as forecasting may be, projected test year data based on reasonable forecasts should consistently come closer to expressing future conditions than will historic data as traditionally used.

Tr. 615-617; AAL St. 1, Appendix A at 3. I agree.

(1) *Capital Structure*

WPP correctly used its targeted future capital structure to determine its long-term projected cost of capital. Tr. 1043. Mr. Davila did not forecast APS' long-term capital structure. Tr. 605-607, 639, 643. In my opinion, it was incorrect for Mr. Davila to use the embedded capital structure from the WPP rate proceeding at R-850220 (Opinion and Order entered in July, 1986).

(2) *Cost of Debt*

APS forecasted future bond rates, whereas Mr. Davila determined bond rates by using an average over the last three months before the hearings in this proceeding. Although Mr. Davila claims that fluctuations tend to average out over the three month period (Tr. 637), WPP has shown that the use of a three month average to forecast future bond rates is unreliable because of the volatility of the bond market over time. WPP M.B. at 33-34; Tr. 607-08; WPP Ex. 22.

Mr. Davila criticizes WPP's bond rate calculation because APS's chief financial officer at the time, John

Adams (now retired), adjusted the seven year Data Resources, Inc. (DRI) bond forecast upward. Tr. 1045-48, 1270-83; AAL Ex. 78.

Between 1985 and 1986, DRI lowered its long-term bond forecasts by about one and a half percentage points. Tr. 1323. Mr. Adams did not adopt the DRI forecast in 1986, and did not drop forecasted bond rates as precipitously as did DRI. In not doing so, Mr. Adams used independent judgment and experience. Tr. 1280-83. Mr. Adams' judgment can be relied upon here owing to his being APS' chief financial officer for over 10 years and owing to his experience in raising capital for the construction of large coal-fired power stations. Tr. 1322. Mr. Davila acknowledged judgment and experience can be used in making long term forecasts. Tr. 1284-85. It turns out that Mr. Adams' experience and judgment were better than DRI's because its 1986 forecast of future bond rates has not been borne out by 1989 experience. Tr. 1284, 1325.

I recommend aceptance of WPP's cost of debt.

(3) *Cost of Preferred Stock*

APS deducted 100 basis points from its 11% cost of debt and arrived at a 10% cost of preferred stock. Tr. 1272-73. Mr. Davila would also use a three month average to determine the cost of preferred stock. AAL St. 1 at 11. His method is rejected, and WPP's method is recommended, for the reasons given in the above discussion on the cost of debt.

(4) *Return on Equity*

APS forecasted its return on equity by adding a risk premium of 400 basis points to the forecasted bond rates. This produced a return on equity of 15%. Tr. 1047-48, 1274-75; AAL Ex. 78 at 4c. The risk premium method is one of several recognized methods for determining the

cost of equity. It is universally recognized that investing in common stock is more risky than investing in bonds. It is assumed, therefore, that to encourage investment in common stock, it is necessary for a company to provide a higher return on common stock than an investor could get in the bond market. Tr. 615.

Mr. Davila supports the use of WPP's opportunity cost of equity determined in its most recent rate case. AAL St. 1 at 9. As WPP points out, this is not a valid forecast of future return on equity because there can be a long time between the rate case ruling and construction of the next generating station. Tr. 1047. WPP also demonstrates that the use of Mr. Davila's methodology in late 1981 results in a cost of debt higher than the return on equity granted in the last WPP rate case (15.8% debt versus 15.25% equity). Tr. 1048-49.

I recommend acceptance of the cost of equity forecast in WPP's FCR.

b. *State and Federal Taxes*

As AAL notes the resolution of this issue depends on the appropriate time frame for the determination of avoided costs. AAL M.B. at 59. AAL adds that even if its time frame is not adopted, WPP's avoided cost calculations are still in error because WPP should have known about and, therefore, used, the change in the federal tax rate in the spring of 1986 (AAL St. 2 at 16) and should have known about the change in the state corporate income tax rate as early as March, 1986. AAL St. 1 at 13. I have not adopted AAL's time frame (the time of signing of the EEPAs) and, therefore, I accept the tax rates used by WPP, namely, those in effect at the time of agreement in principle on rates (which is the same time as the serious negotiations standard of the Commission). *See* discussion at Section III C above. Also, as Mr. Kave pointed out, at the time the agreements in principle were reached, the language of the TRA-86

had not been finalized, hundreds of transition rules were being developed, and even tax experts did not know what the effects of TRA-86 would be. Tr. 115-16. Finally, changes in the tax laws after 1986 could not be predicted, and these changes could result in either increases or decreases in avoided costs. Tr. 306.

APS used the correct level of state and federal taxes in calculating its FCR.

c. *Ad Valorem Rate (Insurance and Property Taxes)*

WPP used a 1.3% ad valorem tax which included .3% for insurance and 1% as an average of property related taxes over the APS system. Tr. 1083. Mr. Davila analized property taxes paid as a percent of gross plant for the APS operating companies over the years 1985-1987. AAL St. 1 at 14; Tr. 621. He weighted the resulting operating company property tax rates to arrive at a system wide property tax rate of .52%. AAL St. 1 at 14. Mr. Davila did not include insurance costs as part of the FCR because insurance is included in the energy rate as part of operation and maintenance expenses. Tr. 651.

Mr. Davila did not, however, consider the effects of the Pennsylvania and Maryland Capital Stock Taxes and the West Virginia Business and Occupation Tax. Tr. 1055-56. Mr. Davila did not know if he took into consideration the Pennsylvania Capital Stock Tax, and also stated that he was not familiar with the Pennsylvania Capital Stock Tax. Tr. 622-23. Also, he did not consider the West Virginia Business and Occupation Tax. Tr. 623-24.

As WPP witness Binder explained, APS' tax liabilities under the Pennsylvania and Maryland Capital Stock Tax laws and the manufacturer's tax portion of the West Virginia Business and Occupation Tax are affected by the construction of a generation plant and are, therefore, properly included in the fixed charge rate. Tr. 1056-58.

AAL attacks WPP's 1.3% ad valorem tax for two reasons. First, .3% should not have been included for insurance because it is included in the energy rate as part of operating and maintenance expenses. Second, WPP has not documented the accuracy of its 1% assumption for the property tax rate.

To rebut the first reason, WPP refers to the EEPAs and to FERC accounts and regulations. WPP R.B. at 25. The EEPAs make clear that WPP's avoided energy costs are calculated based upon costs chargeable to FERC accounts 500 through 507 and 510 through 514. *See* the description of energy purchase prices, AAL Ex. 11, Section 1.2; AAL Ex. 24, Section 1.2; AAL Ex. 40, Section 1.2. *See also* the definitions of "Avoided Energy Cost Rate", "Average Production Cost Rate", "Variable Energy Cost Rate", and "Fixed Energy Cost Rate", AAL Ex. 11, Section 9.1; AAL Ex. 24, Section 9.1; AAL Ex. 40, Section 9.1. According to the FERC's regulations, the 500 through 507 and 510 through 514 accounts cover certain operation and maintenance expenses involved in steam power generation. *See* 18 C.F.R. Part 101 for a description of these FERC accounts. I agree with WPP that Mr. Davila's position on insurance costs is inconsistent with the terms of the EEPAs.

To rebut the second reason, WPP refers to FERC accounts and regulations once again. WPP R.B. at 25-26. The insurance costs included in the ad valorem rate represent property related insurance. Tr. 1081-82. Under the FERC's regulations, 18 C.F.R. Part 101, property insurance costs are chargeable to account 924, and not to one of the 500 series accounts enumerated in the EEPAs:

> 924 Property insurance.
>
> A. This account shall include the cost of insurance or reserve accruals to protect the utility against losses and damages to owned or leased property used

> in its utility operations. It shall include also the cost of labor and related supplies and expenses incurred in property insurance activities.

WPP concludes that because the property-related insurance costs were not included in the calculation of the avoided energy cost rate, and because the property-related insurance is a relevant cost associated with avoided capacity, it was proper for APS to include the property insurance costs in the ad valorem rate when APS was calculating its FCR. I agree.

I recommend acceptance of the ad valorem rate in the APS FCR.

d. *Rate Base*

The calculation of the year by year revenue requirements for determination of an FCR requires the use of a rate base. Tr. 1038-1041; WPP Ex. 21. A year by year revenue requirement is calculated by adding, among other things, the annual book depreciation plus the cost of capital and applying a present worth factor. Tr. 1040; WPP Ex. 21.

WPP used a beginning of the year rate base, but Mr. Davila modified WPP's revenue requirement calculation to reflect an average rate base. AAL St. 1 at 6-7; AAL St. 1, Appendix A at 3. The average rate base model he used, however, does not include discounting to present worth. Tr. 620. The revenue requirement calculations done by Mr. Davila and APS are necessarily discounted to present worth, Tr. 617-18, 1041, and, therefore, require a different model than the average rate base model. Tr. 1041-42. As Mr. Binder demonstrated, Mr. Davila's model has the anomalous result of making the book depreciation plus the cost of capital, discounted to present worth, yield a result lower than the initial investment. Tr. 1040-41; WPP Ex. 21. This conflicts with Mr. Davila's acknowledgement that the book depreciation plus the cost of capital, with appropriate discount factors applied, should equal the initial investment. Tr. 617.

Mr. Davila's method is rejected and WPP's is accepted. Mr. Davila's method is flawed for the above reasons. WPP's method, which is different than the average rate base model, is correct for developing an FCR for cost recovery over an extended period. Tr. 1038-1042; WPP Ex. 21.

e. *Recommendation*

In consideration of the above, I conclude that WPP's FCR is calculated correctly. I recommend its acceptance.

6. *Section 527 of the Code*

AAL argues that, in Pennsylvania, purchases from QFs must be less than avoided costs because Section 527 of the Code, 66 Pa. C.S. § 527, mandates that the purchases must result in savings to the ratepayers. AAL M.B. at 47-48.

Section 527 provides that:

> The commission shall promulgate rules and regulations concerning the rates, terms, conditions and availability of cogeneration in this Commonwealth. The commission shall require that utility rates to the public reflect savings to the utility from cogeneration.

In rejecting AAL's position in its Order on Reconsideration entered January 19, 1989, the Commission stated as follows:

> Suffice it to say that, absent a voluntary agreement otherwise, rates paid to a qualifying facility must be based under federal law on a utility's full avoided costs, and any state requirement that a qualifying facility involuntarily accept a lower rate would be preempted. (emphasis in original)

Mimeo at 6. In response, AAL argues that since in fact there can be no savings to the ratepayers with the use of

the full avoided cost standard, logic dictates that Section 527 was intended to apply where the full avoided cost standard does not apply, i.e. in the case of the voluntarily negotiated contract.

AAL agrees with the conclusion of the Commission that "absent a voluntary agreement otherwise" Section 527 would be preempted by federal PURPA standards. But, if Section 527 is to have any application at all, AAL concludes, it must mean that in cases such as those under consideration where there is a voluntarily negotiated contract, the Commission must find that there are savings which result to the utility's ratepayers. AAL R.B. at 21.

AAL is engaging in legislative mindreading with no support except stretched logic. If Section 527 cannot be applied to the avoided cost calculated under the Commission's regulations it also cannot be applied to a voluntary agreement where, as determined by the Commission, the rates are set at full avoided costs. Besides, the record here demonstrates that the EEPA rates are below WPP's avoided costs so, even though not mandated by Section 527, there already is a savings passed on to the ratepayers.

The second sentence of Section 527 has no application to avoided costs set under the Commission's regulations or under negotiated contracts.

7. *OCA's Correction to the MEI EEPA*

OCA argues that the Milesburg EEPA capacity rate should be reduced from 3.3¢/Kwh to 3.12¢/Kwh to reflect the monthly payments made under the contract. OCA M.B. at 66-70. Mr. Biewald testified that the MEI capacity rate calculation is inconsistent with the calculation used for the Burgettstown and Shannopin projects. For these later two projects, WPP added a Step 8 to calculate the time value of money effect of paying the QFs for their power monthly. The Milesburg rate, how-

ever, was calculated as if the payments were made annually. OCA St. 1 at 9.

OCA argues that to reflect the value of the QF capacity to the WPP ratepayer, which capacity was scheduled to go on line in 1990 under the EEPA but would otherwise not be required by WPP until 1995, the actual monthly payments to Milesburg must be reflected in the discounting formula. Mr. Biewald testified as follows:

> Like the Burgettstown and Shannopin projects, Milesburg will receive energy payments on a monthly basis. For that reason, I have used the same methodology for calculating the Milesburg payments that I used for calculating the Burgettstown and Shannopin payments. My use of the refined methodology shows that the proposed Milesburg rate is above the level that would result from the Company's own current calculation methodology.

OCA St. 1 at 9.

Mr. Kave, a WPP witness, seems to confirm Mr. Biewald's adjustment. He testified as follows:

> Q. Mr. Kave, but would you agree that under the West Penn Power formula, when the Milesburg rates were calculated, West Penn was using an annual payment assumption in determining those rates?
>
> A. The methodology that was in use at that point in time calculated the capacity rates available to any project on the basis of an annual capacity rate.
>
> Q. And when the Burgettstown and Shannopin rates were calculated, West Penn Power had gone to a monthly payment assumption, is that correct?
>
> A. I have a little difficulty with your words payment assumption, but I think that's correct.
>
> Q. Let me try to be very specific. In the West Penn Power method you use a mathematical formula which makes certain assumptions as to the frequency

with which the QFs would be paid for their capacity, is that correct?

A. Generaly that's correct.

Q. And again, for Milesburg it was annual, for Burgettstown and Shannopin it was monthly?

A. That's correct.

Q. In fact, are each of these three projects to be paid on a monthly basis under their contracts?

A. Yes.

Q. And if you were—let me rephrase that. Holding all other assumptions equal, if you were to calculate a rate based on an annual payment or a monthly payment, how would those rates differ?

A. The monthly payment rate would be smaller.

Tr. 69-70.

Although all three projects rates are the result of negotiated contracts, there is no evidence in this record to support using a different method to calculate the MEI rates. The MEI EEPA was first in time. After it was executed, WPP added Step 8 to its calculation in the other EEPAs. Without Step 8, the MEI capacity rate calculation is flawed because under it payments are made monthly but calculated as though made annually. The MEI rate does not accurately reduce the cost of future capacity to present value and does not, therefore, render ratepayers indifferent to paying for WPP's capacity or for a QF's capacity.

WPP's Reply Brief is silent on this issue. MEI points out that WPP's methodology was not amended until after the MEI calculation was finalized. MEI claims that by requesting a hindsight change in WPP's methodology, OCA is engaging in a selective modification of the methodology. BM&S R.B. at 34-35. This is an interesting argument in light of the nature of MEI's petitions to modify its EEPA. MEI is wrong. The calculation of its EEPA rate is incorrect. WPP should have used Step 8 and inserting it now is a correction, not a hindsight

modification. I recommend that the MEI EEPA capacity rate be reduced from 3.3¢/Kwh to 3.12¢/Kwh. This assumes the Commission resuscitates the MEI EPA which has lapsed. *See* discussion in Section IV A below.

8. *Capacity Costs Allocated on a Demand/ Energy Basis*

Presently, QF capacity payments are recovered from ratepayers through the ECR on a straight energy basis and, therefore, allocated to WPP's customers on the same basis. AAL and WPPII advocate for recovery of QF capacity payments from ratepayers on a Kw demand basis through the ECR but in a manner similar to that which would have occurred if such capacity had been built by the utility and the costs were included in base rates and allocated according to cost-of-service principles. AAL M.B. at 79-86; WPPII M.B. at 20-25.

Noting that were WPP to construct the avoided units (base load coal units), the costs would be allocated in base rates on a demand basis, AAL witness Baron recommends that the long term capacity purchases from the three Projects be accorded the same rate treatment. He suggests use of the same demand allocation method used by WPP in its most recent cost-of-service study, updated to the 12 month period ended June 30, 1986. AAL St. 2 at 24. Although the June 30, 1986 12 month period represented the most recent information available, Mr. Baron strongly encouraged WPP to update its analysis with recent data since the cost-of-service information is a number of years old. AAL St. 2 at 28.

The reasons for using a demand/energy allocation are sound. First, as long as rate recovery is accomplished through the ECR, the method of allocating QF purchase costs to the ratepayers will have no effect on the amount of revenue collected by the utility and passed through to the QF. Second, without a demand allocation of capacity payments ratepayer indifference is lost because high

load factor customers (usually energy intensive customers such as the members of AAL and WPPII) pay higher rates for cogenerated capacity than for utility generated capacity. Third, the current practice of recovering QF capacity payments through the ECR is contrary to accepted cost-of-service ratemaking principles.

OCA recommends that AAL's proposal be rejected. OCA M.B. at 88-92. OCA argues first that the AAL rate structure proposal would add complexity to the calculation and charging of WPP's ECR.

Second, OCA argues that AAL's proposal is based on the inaccurate assumption that QF capacity rates should be allocated based upon a single WPP coincident peak, the method used in the last WPP case. Tr. 687-688. OCA points out, however, that in R-850220, the last WPP rate case, the rate increase was allocated on an energy basis for Bath County costs and a rate reduction related to non-Bath County was also allocated on an energy basis. Tr. 689-90. Also in R-842632 the Commission rejected a staff proposal to use only the coincident peak method. *Pa. PUC v. West Penn Power Company,* 59 Pa. PUC 552, 609 (1985).

Third, OCA agrees with WPP witness Binder that the AAL method of allocating capacity related costs based upon a single coincident peak may result in volatile changes in cost allocations depending upon peak responsibility for a single day. Tr. 1031. Also, Mr. Baron agreed that the cost responsibility allocations provided in the next West Penn base rate case may also indicate the need for additional changes in cost allocations based upon new cost data. Tr. 697-98, 703.

Finally, OCA notes that the rate structure issue is not one which the Commission has set for decision in this case and may be analyzed more appropriately in future base rate or ECR proceedings.

In my opinion, AAL and OCA are both correct. The capacity costs should be flowed through to WPP rate-

payers, via the ECR, on a demand/energy basis, but the allocation should not be set in this proceeding. Any complexity brought to the ECR calculation is outweighed by the true reflection of costs which will result.

It is clear from this record that the current method of using the ECR without a demand/energy allocation discriminates between classes of customers and does not meet the PURPA-mandated standard of customer indifference to the source of capacity. *In re: Middle South Services, Inc.*, 71 PUR. 4th 580, 594, 33 FERC ¶ 61.408 (1985). There is precedent for a demand/energy allocation. The West Virginia Commission allocates the QF capacity costs of Monongahela Power Company (WPP's sister utility) on a demand basis within the fuel adjustment clause. Also, the Virginia State Corporation Commission, in Case No. PUE-880052, concluded that QF capacity costs should be recovered through base rates on a demand/energy basis. AAL St. 2 at 26-27. AAL's method, is flawed, however, because the single coincident peak method has not been used in past WPP rate cases, because it may result in volatile changes in cost allocations, and because Mr. Baron used stale data.

Because the costs in question will not be recovered through WPP's ECR until the next ECR proceeding, and because AAL's method and data are flawed, this is not the appropriate proceeding in which to set the demand/energy allocation. It is the proceeding, however, in which to declare that capacity costs for WPP's QF purchases should be flowed through to WPP ratepayers via WPP's ECR on a demand/energy basis and I so recommend. I recommend also that WPP be directed to make such an allocation, as part of its next ECR filing and that all existing on-line QF capacity at the time of the filing be included. Under Section 1307 of the Code, 66 Pa. C.S. § 1307, the Commission has the authority to direct WPP to do this. To extend this ruling to other electric utilities, however, must await a separate proceeding. It could

be done in the generic cogeneration investigation (I-860025) where the Commission is considering the issue of demand/energy allocations through the ECR.

9. *Excess Capacity*

In its MEI Petition, WPP asks the Commission to find that addition of the MEI capacity "does not result in excess capacity under Section 1323 of the Public Utility Code as to the MEI capacity itself or as to any *existing* West Penn capacity". West Penn Petition at 5-6 (emphasis added). In its Order of September 22, 1987 granting rate approval to West Penn concerning the Milesburg project, the Commission stated that: "the Commission hereby declares that additional generation capacity as a result of the contract between West Penn Power Company and Milesburg Energy, Inc., referenced in ordering Paragraph No. 1, above, shall not be considered by the Commission in determining the reserve margins or economic benefits resulting from *any base load or other generating unit during the terms of the contract.*" Order at 7 (emphasis added).

The Commonwealth Court held that the "Commission may not make such a decision without first providing the ratepayers with notice and hearing." *Milesburg* at 1308. By the Court's remand, therefore, the excess capacity issue, as it applies to all four EEPA Petitions, must be addressed here.

The OCA submits that in this proceeding the Commission should adopt a policy concerning any further excess capacity adjustments to be made on the WPP System. The OCA also asks the Commission to declare that QF capacity *will* be considered in determining whether *subsequent* utility plant additions represent excess capacity. OCA M.B. at 82-87.

Mr. Biewald presented testimony upon the issue of how capacity provided by QFs should be taken into account when determining whether excessive capacity exists

upon a utility system. OCA St. 1 at 68-76. He generally distinguished between excess capacity determinations which take into account generating capacity constructed before and after the utilities' commitment to a QF generating resource. OCA St. 1 at 72-76. Mr. Biewald stated that it is essential to consider QF capacity in deciding whether utility capacity constructed *after* the utilities' commitment to a QF should result in an excess capacity determination. He explained that to do otherwise would double charge ratepayers for QF capacity as they would pay once for the actual QF and once again for excess utility capacity that was to have been avoided by the QF. The utility should not be permitted to charge ratepayers for capacity when it is clear from the generating resources available to it (excluding QFs) that such additional capacity is not required. Mr. Biewald concludes that:

> Thus we reach a very simple conclusion: at least some excess capacity analyses, namely those concerning future utility resource additions, must treat QF capacity in *exactly the same manner as utility-owned capacity*.

OCA St. 1 at 73 (emphasis in original).

Mr. Biewald rejected the Commission's Proposed Policy Statement, issued for comment in the *Pennsylvania Bulletin* on July 18, 1987 at Docket No. L-870030, which declared that QF capacity ought to be included in excess capacity evaluations, only where utilities imprudently bring capacity on line when the existence of the QF would have permitted delay or cancellation.

The OCA submits that the Commission should make clear in these proceedings that it does not intend to adopt its Proposed Policy Statement. The reasons in support of OCA's position appear in OCA M.B. at 85-87. I do not summarize them here because these are not the correct proceedings in which this determination should be made. Comments to the Proposed Policy Statement have

been filed and a final Commission determination is pending in that proceeding (L-870030). While the Commission might or might not choose to follow its proposed policy in these proceedings, a blanket determination is proper in the proposed policy proceeding, not here.

I recommend a finding that addition of the QF capacity in question does not result in excess capacity under Section 1323 of the Code as to the capacity itself or as to any existing WPP capacity.

10. *Capacity Rate Recommendation*

Based on the above discussion I recommend approval of the Monongahela EEPA at an initial energy rate of 3.8¢/Kwh and a capacity rate of 3.6¢/Kwh. I recommend approval of the Burgettstown EEPA at an energy rate as described and applied in Section 1.2 of that EEPA and a capacity rate of 3.6¢/Kwh. I recommend approval of the Shannopin EEPA at an energy rate as described and applied in Section 1.2 of that EEPA and a capacity rate of 4.0¢/Kwh. The rates for Burgettstown assume that the Commission adopts my recommendation, discussed below, to deny the Burgettstown Petition to extend deadlines and to update capacity rates.

I recommend that the Milesburg Petition be denied for the reasons discussed below. If the Commission rejects my recommendation, I recommend that the capacity rate be reduced in accordance with the discussion at Section III D 6 above.

I recommend that WPP be directed to include in its next ECR filing a demand/energy allocation for all QF capacity on-line at the time of the filing of the ECR.

PHASE TWO PROCEEDINGS

IV. THE PETITIONS FOR MODIFICATION

The second phase of these proceedings consists of a hearing to consider two petitions filed pursuant to Section 508 of the Code, 66 Pa. C.S. § 508 which reads as follows:

> Power of the commission to vary, reform and revise contracts
>
> The commission shall have power and authority to vary, reform, or revise, upon a fair, reasonable, and equitable basis, any obligations, terms, or conditions of any contract heretofore or hereafter entered into between any public utility and any person, corporation, or municipal corporation, which embrace or concern a public right, benefit, privilege, duty, or franchise, or the grant thereof, or are otherwise affected or concerned with the public interest and the general well-being of this Commonwealth. Whenever the commission shall determine, after reasonable notice and hearing, upon its own motion or upon complaint, that any such obligations, terms, or conditions are unjust, unreasonable, inequitable, or otherwise contrary or adverse to the public interest and the general well-being of this Commonwealth, the commission shall determine and prescribe, by findings and order, the just, reasonable, and equitable obligations, terms, and conditions of such contract. Such contract, as modified by the order of the commission, shall become effective 30 days after service of such order upon the parties to such contract.

The reader is referred to the History of the Proceedings (Section I above) which relates in part to these petitions and which is not repeated in its entirety here.

A. *MEI's Petitions*

Currently pending in Phase Two of these proceedings are four separate but related Petitions and Motions: 1) the February 8, 1989 Petition for MEI for Modification of An Electric Purchase Agreement; 2) the March 14, 1989 WPP Petition for Leave to Withdraw its original Petition; 3) the March 13, 1989 Motion of AAL to Dismiss the original WPP Petition seeking rate recovery for the costs incurred under the WPP/MEI Agreement; and 4) the May 12, 1989 Petition of MEI for Modification of Petition to Modify Electric Purchase Agreement. The March 3, 1989 Petition of MEI for the Issuance of an Interim Emergency Order or Appeal was denied by Commission Order entered March 31, 1989.

MEI's February 8, 1989 Section 508 Petition requested that the Commission modify MEI's privately negotiated contract with WPP in two ways: 1) to increase the levelized capacity cost rate contained in the Agreement to reflect a delayed in-service date for the project (now anticipated to be in mid-1993. MEI St. 5), or in the alternative, to approve a non-levelized capacity rate; and 2) to extend the Agreement's Financing Closing Date to not later than 120 days after a final and nonappealable Order of the Commission giving approval for recovery of all energy and capacity costs, and all other milestone dates as appropriate.

MEI advances several arguments in support of its position. First, extension of the milestone dates is reasonable, fully supported and justified because:

a) of extensive and unprecedented delays due to litigation of the reasonableness of the EEPA before the Commonwealth Court and the Commission;

b) the Consent Agreement issued by the Commission on September 1, 1988 shows that all parties recognized a likelihood of further extension of the milestone dates;

c) extension of the milestone dates is essential to survival of the MEI Project;

d) in its March 31, 1989 Order, the Commission stated that the EEPA "could be reinstated by extending the financing deadline *nunc pro tunc*, for example, by modifying the contractual provision so that it is not self-executing." Order, at 8.

e) failure of the Commission to modify the EEPA would curtail cogeneration development in Pennsylvania;

f) MEI will suffer a financial loss of millions of dollars without extension of the milestone dates;

g) the Commission recently enunciated a policy of encouraging the extension of contractual milestones in *Petitions of Pennsylvania Electric Company*, P-890353, P-890354 (Opinion and Order entered April 6, 1989);

h) WPP requested MEI to agree to EEPA modifications by letter of February 13, 1989 but WPP refused MEI's request to modify the EEPA despite MEI's requests and the ALJ asking WPP if it would agree to voluntary negotiations on the EEPA (at the March 31, 1989 prehearing conference);

i) the MEI project will benefit the citizens of Pennsylvania and the local community;

k) extending the milestone dates will produce no demonstrable risk to WPP's ratepayers and will not cause planning uncertainty on WPP's system;

l) extending the dates will not result in payments in excess of avoided costs and will not discriminate against other QF's.

Second, modification of the capacity rates from 3.3¢/Kwh to 4.9¢/Kwh is reasonable and justified because:

a) without it the project cannot survive because since the Commission approved the Project in September, 1987, interest rates and the cost of construction and borders has risen substantially;

b) the modification requested by MEI is not in excess of WPP's avoided cost;

c) under the circumstances of this case it is inappropriate to update all of WPP's assumptions because MEI is asking only for an update of the in-service date of the project;

d) MEI's request will not result in uncertainty for financing entities;

e) MEI's request will not cause widespread use of regulatory out clauses (requiring utility payments to QFs only if the utility receives money from its ratepayers for that period).

The testimony and exhibit references as well as the full argument of the Projects in support of the above appear at pages 66 to 84 of the BM&S Main Brief. MEI's arguments are not discussed further because the MEI contract has lapsed and cannot be changed under Section 508. Even so, many of the issues raised by MEI's petition are similar to the Burgettstown Petition and are discussed in Section IV B below.

One of the key original provisions in the EEPA between WPP and MEI, Section 10.2, provided as follows:

> "If the Financing Closing Date shall not occur prior to September 1, 1988 for any reason whatsoever, including *Force Majeure,* this Agreement shall automatically terminate in which case neither party shall have any further liability to the other hereunder."

Immediately before the September 1, 1988 automatic termination of the Agreement under Section 10.2, the parties to the Milesburg proceeding entered into a Consent Agreement which resulted in a Consent Order issued by the Commission on September 1, 1988. AAL Ex. 80.

This Consent Order extended the September 1, 1988 Financing Closing Date to February 28, 1989 and provided as follows:

> The Financing Closing Date set forth in Section 10.2 of the Agreement is hereby extended to and including February 28, 1989, and any other dates, including the earliest possible commencement date, in the said agreement that is dependent on the said Financing Closing is extended for a like period. *Should the Financing Closing Date not occur on or before February 28, 1989, the Agreement will automatically terminate pursuant to Section 10.2, unless otherwise extended by further order of this Commission.* (emphasis added)

The Financing Closing Date was not extended by further order of the Commission before February 28, 1989 because MEI did not file its petition soon enough for Section 508 to be used to modify the EEPA before the deadline. The question before me, therefore, is whether Section 508 empowers the Commission to retroactively reinstate the MEI EEPA which automatically terminated under its own terms.

WPP, AAL and WPPII argue that because the contract MEI seeks to modify has lapsed, there is no contract to modify and Section 508 does not apply. WPP M.B. at 79-80; AAL M.P. at 88-89; WPPII M.B. at 26-27.

In my view, this is a contractual issue because Section 508 gives the Commission the "power and authority . . . to vary, reform, or revise . . . any terms, or conditions . . . of any *contract* . . . between any public utility and any . . . corporation" (emphasis added). There is no contract between WPP and MEI upon which the power vested in the Commission by Section 508 can operate. Section 508, therefore, is inapplicable here. MEI does not address this point and it has advanced no legal authority to support the retroactive modification of a contract which no longer exists.

In its Order entered March 31, 1989 denying MEI's Emergency Petition, the Commission stated with respect to MEI's Section 508 Petition that "should MEI prevail, the Electric Energy Purchase Agreement between MEI and West Penn could be reinstated by extending the financing deadline *nunc pro tunc,* for example by modifying the contractual provision so that it is not self-executing." Order at 8. The proper function of a *nunc pro tunc* order, however, is to make the record speak the truth. Such an order corrects the record so that it truly reflects an action really taken, but which through some inadvertence or mistake has not been recorded. *In re: Jurkowitz Estate, Pa.,* 59 A.2d 895 (1948); *Matthies v. Railroad Retirement Board,* 341 F.2d 243 (8th Cir. 1965). *See also* 2 Am. Jur. 2d, Administrative Law § 521. In my opinion, the Commission's observation about the application of the doctrine of *nunc pro tunc* is incorrect because there is no existing Commission judgment before February 28, 1989 to be corrected by the doctrine. Even if the consent order could be considered as a Commission judgment, an order *nunc pro tunc* would be inappropriate because there is no mistake in the consent order and nothing was inadvertently omitted from it.

I note also that the Consent Order specifically precludes higher capacity payments. Paragraph 3 of the Consent Order reads as follows:

> MEI shall not seek nor be entitled to any capacity credit higher than that specified in the Agreement executed on or about February 25, 1987.

AAL Ex. 80. I reject MEI's argument that the consent order does not bar increased capacity rates. MEI argues that because the modified rates are below the rates which would be calculated under WPP's methodology or the regulations, these do not represent an increase in rates. BM&S R.B. at 47-48. It *does* represent an increase in

capacity rates. MEI's petition should be denied for this reason also.

MEI argues that the legally enforceable obligation of WPP to purchase energy from MEI is not dependent on the existence of a contract. The obligation exists pursuant to PURPA which requires the utility to purchase energy from a QF at rates as of the time that there is a legally enforceable obligation, as defined by state law. (45 Fed. Reg. 12224). According to MEI, WPP misreads 18 C.F.R. § 292.304(d) as requiring this proceeding to be viewed strictly under contract law. That section refers to the utility's legal obligation to purchase from the QF, whether or not a contract is in effect. The QF has the option, before commencement of the term of the agreement, to choose whether it wants its avoided cost payments based on time of delivery or the time the obligation is incurred. (18 U.S.C. § 292.304(d)(2)(i) and (ii)). MEI concludes that, in Pennsylvania, WPP is compelled to purchase from MEI from the time serious negotiations took place. For MEI, that obligation was formed by May, 1986 or earlier. BM&S R.B. at 46.

While it appears that WPP is required by PURPA to purchase power from MEI, WPP is not required to do so under the lapsed EEPA. To require WPP to purchase its power, MEI must file a petition with the Commission to set rates as of the time of serious negotiations *under the provisions of the Commission's PURPA regulations.* MEI's argument does not resuscitate the lapsed contract.

It is clear that the MEI Project would be beneficial to the Commonwealth. It will allow for the reclamation of land on which coal waste is stored. It will provide needed employment in the Belefonte area, perhaps improve water quality there, help pay for part of the improvement of a railroad bridge and provide business for a local railroad company. MEI St. 4. It is also clear that MEI could not have foreseen the delays caused by litigation. This is a risk that any developer must bear,

however. Despite the obvious equities in favor of the MEI Project, the EEPA does not exist and cannot be approved. If the Commission disagrees, the EEPA should not be modified for the reasons given above and in section IV B below.

I recommend that MEI's Petition for modification be denied and that WPP's Petition to withdraw and AAL's Petition to dismiss be granted. That leaves MEI's May 12, 1989 Petition to modify its petition to modify.

MEI's May 12, 1989 Petition is a petition to modify a petition to modify a contract that no longer exists. MEI's Petition seeks the same type of modification sought by North Branch. *See* Section IV B below. Through it MEI seeks to avoid business risks which it voluntarily accepted in the EEPA. A discussion of the merits of the May 12, 1989 Petition is unnecessary because the underlying contract, the EEPA, has lapsed and cannot be modified. I recommend that MEI's May 12, 1989 Petition be denied for this reason and for the same reasons for which the Burgettstown Petition should be denied.

B. *The Burgettstown Petition*

As in the MEI Petition, the North Branch Petition (for the Burgettstown Project) is in two parts. First, it asks for modification of milestone dates and second, it asks for an increased capacity rate to reflect the new in-service date. This discussion will also refer to the Milesburg Petition because the issues raised by both Petitions are similar, even though the MEI EEPA has lapsed.

In the Burgettstown EEPA, the capacity credits are based on the QF being placed in service on October 1, 1991. If it is not placed in service by October 1, 1993, Burgettstown will be in default. Based on those dates, Burgettstown is to have a financial closing on October 1, 1989 and is to make a final good faith deposit of $360,000 on July 1, 1989. According to North Branch, the developer of the Burgettstown Project, these dates

were agreed to on October 15, 1987 based on a belief that the pass-through provisions of the EEPA would be ruled on favorably by the Commission as was done in the Milesburg Project (by order entered September 22, 1987). After that, however, appeals were filed with the Commonwealth Court which resulted in a decision that bill insert notice needed to be sent to ratepayers and due process hearings needed to be held. Due to those unforseen circumstances, North Branch notes, there has been a year and a half period during which no meaningful engineering, financing or construction activity could take place.

Due to this delay, North Branch filed its petition for modification so that, according to North Branch, the now unrealistic milestones in the Project may be modified so as not to jeopardize the project while, at the same time, protecting WPP's generation planning study.

Mr. Brooks testified that construction of the plant from the date of financial closing would take approximately 33 months. Tr. 1368. This testimony was not rebutted. Mr. Hoehler testified that it would take approximately six months from the date of a final order to have a financial closing. Thus, assuming that a final unappealable order were to be issued in this case on October 1, 1989, a closing could not be held until approximately April 1, 1990 and the plant could not be constructed and placed in service until approximately January 1, 1993. North Branch concludes that if its Project is to be approved, the contract dates must be modified. BM&S M.B. at 85.

Paragraph 18 of the North Branch Petition sets forth the specific EEPA modifications requested and reads as follows:

> 18. Due to the delay caused by the intervenors, the following dates in the Agreement must be modified as follows:

a. "Financial Closing Date" shall be defined as six (6) months from the date of a final order in this proceeding.

b. The second sentence of Section 2.1 of the Agreement shall be modified to read as follows:

"The parties currently estimate that with the exercise of such diligence Seller shall be able to place the Project in service at the Contract Output no later than thirty three (33) months from the Financial Closing Date.

c. Section 6.1(a) shall be modified to change the event of default date as follows:

(a) the Commencement Date shall not occur prior to fifty-seven (57) months from the Financial Closing Date or October 1, 1995 whichever is earlier.

d. The final Good Faith Deposit of $360,000 shall not be due until three (3) months prior to the Financial Closing Date.

e. All dates which relate to the above dates shall be adjusted automatically.

f. The capacity credit shall be modified to be the avoided capacity credits calculated pursuant to West Penn's PURPA 210 filing of July 31, 1986 and calculated as of the modified in service date in Section 2.1 of the Agreement which is set forth in subparagraph 18b. hereof.

The parties have litigated this issue thoroughly. BM&S M.B. at 87-89, R.B. at 35-49; WPP M.B. at 81-87, R.B. at 32-46; AAL M.B. at 95-99, R.B. at 46-48; OCA M.B. at 93-97, R.B. at 31-32.

I note first that although the North Branch Petition seeks a modified capacity credit based upon WPP's July 31, 1986 PURPA filing with the Pennsylvania Commission, the supplemental testimony of Mr. Ross on behalf of Burgettstown (Burgettstown St. 7) does not calculate a modified capacity credit on that basis. Instead, Mr. Ross calculates increased rates based upon the WPP method for calculating avoided costs under the assumption of a later in-service date for the QF. There is, therefore, no testimony to support the capacity rates requested in North Branch's Section 508 Petition. The North Branch Petition does not specify a requested capacity credit, and the supplemental testimony of Mr. Ross sets forth an increased capacity credit based upon a methodology which is different than that requested in the Petition. There is no way of knowing, therefore, what rate North Branch is requesting. The Petition should be denied for this reason. There are, however, other reasons why the Petition should be denied.

The North Branch Petition requests an open-ended modification of the Financial Closing Date (six months from the date of a final order in this proceeding, instead of October 1, 1989); requests an open ended in service date (no later than 33 months from the Financial Closing Date, instead of between April 1, 1991 and October 1, 1991); requests an open ended event of default date (57 months from the Financial Closing Date or October 1, 1955 whichever is earlier); and requests that all related dates be adjusted automatically. This is unlike the February 9, 1989 MEI petition which requests extension of the Financing Closing Date to no later than 120 days after a *final and nonappealable order of the Commission.* North Branch's extension is not predictable. It is doubtful that any appeals taken from the Commission's Order could be litigated within six months. This applies also to MEI's May 12, 1989 Petition.

North Branch cites *Petition of Pennsylvania Electric Company Re: X10X Corporation,* Docket Nos. P-89035

and P-890354 (April 6, 1989) as enunciating the Commission's policy of encouraging voluntary extensions of financing and/or commercial operation or related deadlines. It suggests that WPP's actions are contrary to that policy. BM&S M.B. at 43. But, as WPP points out, the Commission also observed that orderly capacity planning is a legitimate concern of utilities:

> Our discussion should not be read as discouraging utilities from utilizing *reasonable* milestone dates in their contracts with qualifying facilities. A concern independent of the reasonableness of rates paid to qualifying facilities is the need by a utility to plan its capacity additions to match its anticipated load growth.

Opinion and Order, April 6, 1989, at 7 (emphasis in original).

The question to be resolved is whether WPP's refusal to agree to the extensions is motivated by lack of support for the projects (this issue applies to Milesburg also, if the Commission resuscitates the MEI EEPA) or whether it is motivated by the desire to avoid significant planning uncertainties and impairment to its ability to serve its customers if the projects fail to go into commercial operation. Resolution of this issue turns on the risks to be borne by the parties.

WPP's Main Brief, pages 60-67 contains an excellent discusison of the dynamics of the lengthy and complex negotiation process leading to the EEPAs and how the EEPAs address how the risks are to be borne by all affected parties, including the project lenders, constructors, operators, WPP and its customers. I have attached these pages as Appendix A and incorporate them herein.

Many observers are concerned that electric utilities are hostile toward cogeneration because it impairs their control over their generation, generation planning and return on rate base. The record in this proceeding does

not demonstrate this hostility, if it exists generally, on the part of WPP or APS. What the record does demonstrate is a deep concern on the part of both that the EEPAs allow them to insure that, at important stages of development, the project is progressing and that if it is not they can take steps to safeguard their system reliability and generation needs. This is vital in light of WPP's duty to serve the public under Section 1501 of the Code, 66 Pa. C.S. § 1501. The Projects argue that the contract was not truly negotiated because WPP was inflexible regarding the EEPA. The record does not demonstrate this. Also, if the Projects felt that way they could have opted to sell their power to WPP under the Commission's regulations.

WPP did grant a limited extension to MEI in the Consent Order entered by the Commission on September 1, 1988. The extension requested by North Branch for the Burgettstown Project, and by MEI, however, are not for short, limited periods of time at the price originally negotiated. Instead the developers request prolonged extensions covering periods much beyond those originally negotiated by the parties and at increased capacity rates. This changes the planning risk WPP negotiated in the EEPAs.

WPP witness Albert Kave testified that the planning risks associated with reliance on a proposed QF project decrease significantly at two points: at the time of agreement in principle on purchase rates and at the time of the financial closing. WPP St. 1 at 9; WPP St. 4 at 5; Tr. 83-86 and 297. Neither of these projects have had a financing closing and the proposed extensions provide no assurance that a financing closing date will occur within a reasonable period of time. The proposed cutoff date for the Burgettstown project's in-service date of October 1, 1995 (as well as the cutoff date of January 1, 1995 recently proposed for the Milesburg project in MEI's May 12, 1989 Petition) does not provide WPP with enough planning certainty regarding these projects.

WPP would have insufficient time before its planned need for capacity to replace these projects if they should fail to go into service by the proposed cutoff dates. The extensions would push the Burgettstown financial closing deadline to as late as late 1992 or early 1993 because construction of the project will take at least 30 to 33 months. Tr. 1368, 1400. Judging from the history of these proceedings there is the likelihood that a party or parties will seek review of the Commission's final order in the Pennsylvania courts and perhaps in the federal courts. If so, it is highly unlikely that either MEI or North Branch will meet any of the extended deadlines. This further increases the risk to WPP and its ratepayers that WPP will be unable to arrange alternative sources of power.

It can be argued that even without the increased capacity rates, the extensions benefit WPP ratepayers because of the postponement of payments. It would be useless to approve the extensions without the increased rates, however, because the developers have made it clear that without both, the projects will fail.

The developers argue that the extensions are needed because they have spent millions of dollars on the projects and because the projects are in jeopardy owing to the delays in these proceedings resulting from *Milesburg*. The amount of money spent on the projects does not mean they will go into service. The developers were always at risk that, no matter how much money they spent, WPP's obligation under the EEPAs would cease upon a missed milestone date. *See* AAL Ex. 11, Sections 5.7 and 10.2; AAL Ex. 24, Sections 5.7 and 10.2. It is clear that the business "deal" between WPP and the developers placed the risk of construction related cost increases on the developers at all times, even if those cost increases were to render the projects infeasible.

The delays in Commission approval of the EEPAs, while the fault of neither WPP or the developers, is a

risk to which the developers have always been subject. Even so, the developers are requesting a higher capacity rate to offset cost increases which occurred during the delays. It is incorrect to shift this burden to the ratepayers because it was not part of the original business arrangements, the EEPAs. The developers' petitions should be denied for this reason.

Another reason for denying the petitions is the lack of consistency. The time frame argument of the cogenerators in Phase One above favors the time of serious negotiations for the following reasons, enunciated at BM&S Main Brief at 34-35:

> Mr. Ross testified that "it is inappropriate and inequitable for the parties who have negotiated an EEPA in good faith, *based on the circumstances occurring during the time that serious negotiations were taking place, to be held accountable for knowing the outcome of the future events.*" (BM&S, St. 1 at 17-18). If a QF and a utility agree on rates based upon projections of a utility's avoided cost as of the time of serious negotiations, *and those rates are later modified to reflect changed circumstances* . . . the economic feasibility of the project as well as the goal of PURPA will be frustrated.
>
> * * * *
>
> The projects have *refrained from using hindsight* by not extracting data from a time period other than the time of serious negotiations by each party (emphasis added).

In Phase Two, however, Burgettstown and MEI argue for higher capacity rates to reflect changed circumstances existing in 1989. It is inconsistent for the cogenerators to argue on one hand that TRA-86 should not be considered in calculating avoided costs while arguing on the other hand that negotiated capacity payments should be increased because of unforeseen events occurring in 1989, which events delayed the project in-service dates.

If the developers are permitted to modify the negotiated EEPAs here because of unforseen events, the contracts between WPP and the cogenerators become meaningless. Such a decision will lead to a reluctance of utilities to negotiate such contracts in the future. Of course, the denial of modifications should work both ways. That is, if avoided costs decrease after a contract is signed, the utility should not be allowed to modify the contract to reduce the capacity costs. Such a policy instills consistency and predictability in the utility/QF relationship which should foster the growth of reliable QF projects.

I recommend that, for the above reasons, the North Branch Petition be denied. The above reasons also support denial of the MEI Petition, denied above for other reasons.[14]

C. *Notice to Ratepayers*

AAL argues that WPP was required under Section 508 of the Code to send out notices that a rate modification was requested and that the notice which was sent previously to WPP's ratepayers is insufficient. AAL M.B. at 93-95, 98. I discuss this issue, even though modification is denied above, because it is relevant to future proceedings.

At times a utility changes the level of its Revenue Requirement during a base rate proceeding owing to data updates. A new notice is not required because the original notice is sufficient to notify all interested parties of the prospective change in rates and gives them an opportunity to participate. WPP's bill inserts accomplished the same purpose. The modification requests here are no different than a changed level of rate relief in a base rate proceeding. Accordingly, neither MEI nor North Branch were required to issue new notices.

---

[14] North Branch and MEI can resort to the Commission's regulations to sell their power to WPP.

V. RECOMMENDED ORDERS

I recommend that the Commission issue four separate orders in these proceedings. No apeal from the Monongahela Petition is possible if the petition is approved as applied for because no party contested that petition. Including all petitions in one order, however, could delay the Monongahela Project unnecessarily if any party appeals from the Commission's Order.

A. *Recommended Milesburg Project Order*

Therefore,

IT IS ORDERED:

1. That the Petition of West Penn Power Company at Docket No. P-870216 to withdraw its Petition at Docket No. P-870216 for approval of an Electric Energy Purchase Agreement entered into with Milesburg Energy, Inc. (for the Milesburg cogeneration project) is granted.

2. That the Petition of Milesburg Energy, Inc., filed February 9, 1989 for modification of the Electric Energy Purchase Agreement referenced in paragraph 1 of this order is denied.

3. That the Petition of Milesburg Energy, Inc., filed May 12, 1989, for modification of the Petition referenced in paragraph 2 of this order is denied.

B. *Recommended Monongahela Project Order*

Therefore,

IT IS ORDERED:

1. That the Petition of West Penn Power Company at Docket No. P-880283 for approval of an Electric Energy Purchase Agreement entered into with Noah Corporation (for the Monongahela Lock and Dam No. 8 cogeneration project) is granted.

2. That the rates set in the Electric Energy Purchase Agreement are just and reasonable.

3. That upon the occurrence of all conditions precedent in the Electric Energy Purchase Agreement, West Penn Power Company is authorized to pass through to its ratepayers by way of its Energy Cost Rate all charges resulting from the Agreement.

4. That in its next Energy Cost Rate filing, West Penn Power Company allocate all of its charges under cogeneration projects on-line as of the date of filing of the Energy Cost Rate on a demand/energy basis.

5. That the addition of capacity West Penn Power purchases under the Electric Energy Purchase Agreement does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn Power Company capacity.

C. *Recommended Burgettstown Project Order*

Therefore,

IT IS ORDERED:

1. That the Petition of West Penn Power Company at Docket No. P-880284 for approval of an Electric Energy Purchase Agreement entered into with North Branch Energy Partners, L.P. (for the Burgettstown cogeneration project) is granted.

2. That the Petition of North Branch Energy Partners, L.P. for modification of the Electric Energy Purchase Agreement referenced in paragraph 1 of this order is denied.

3. That the rates set in the Electric Energy Purchase Agreement are just and reasonable.

4. That upon the occurrence of all conditions precedent in the Electric Energy Purchase Agreement, West Penn Power Company is authorized to pass through to its ratepayers by way of its Energy Cost Rate all charges resulting from the Agreement.

5. That in its next Energy Cost Rate filing, West Penn Power Company allocate all of its charges under

cogeneration projects on-line as of the date of filing of the Energy Cost Rate on a demand/energy basis.

6. That the addition of capacity West Penn Power purchases under the Electric Energy Purchase Agreement does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn Power Company capacity.

D. *Recommended Shannopin Mine Project Order*

Therefore,

IT IS ORDERED:

1. That the Petition of West Penn Power Company at Docket No. P-880286 for approval of an Electric Energy Purchase Agreement entered into with Mon Valley Energy Corporation (for the Shannopin Mine cogeneration project)is granted.

2. That the rates set in the Electric Energy Purchase Agreement are just and reasonable.

3. That upon the occurrence of all conditions precedent in the Electric Energy Purchase Agreement, West Penn Power Company is authorized to pass through to its ratepayers by way of its Energy Cost Rate all charges resulting from the Agreement.

4. That in its next Energy Cost Rate filing, West Penn Power Company allocate all of its charges under cogeneration projects on-line as of the date of filing of the Energy Cost Rate on a demand/energy basis.

5. That the addition of capacity West Penn Power purchases under the Electric Energy Purchase Agreement does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn Power Company capacity.

Date: June 8, 1989 /s/ Larry Gesoff
LARRY GESOFF
Administrative Law Judge

APPENDIX L

Appendix A to Recommended Decision of June 27, 1989 (Pages 60-67 of West Penn Power Company's Main Brief Filed May 16, 1989)

D. *The Electric Energy Purchase Agreements.*

The issues raised by the Petitions for Modification cannot properly be evaluated without an appreciation of the dynamics of the negotiation process and the voluntary agreements ultimately reflected in the EEPAs. The EEPA with MEI is AAL Ex. 11, and the EEPA with North Branch is AAL Ex. 24.

Each of these transactions involves complex commercial arrangements, involving millions of dollars, that are very extensively negotiated and ultimately address the manner in which the perceived risks of the transaction, which are substantial, are to be borne by all affected parties, including the project lenders, constructors, operators, and the utility and its customers. Modifying one term of such a contract inevitably undercuts the assumptions on which at least one party relied in agreeing to other terms of the contract (and even in agreeing to other contracts), and fundamentally alters the business risks to that party of entering into the transaction as well as the basic business deal to which it thought it had agreed.

The fundamental business risk of the transaction, from the point of view of the utility and its customers, is that the QF will not turn out to be as reliable a source of capacity to serve the utility's customers as the utility's own generation would have been. Indeed, for the first time in WPP's history, its ability to adequately serve its customers will be substantially dependent upon outside, unregulated sources over which neither it nor the Commission has any direct control. APS operating companies have signed contracts with 15 QFs representing 846 MW

of capacity, or about 10% of the capacity in the APS system. WPP St. 1 at 6. The extensive contract terms embodied in the EEPAs are primarily focused on assuring that the QF will be a reliable source of capacity to supply the needs of WPP's ratepayers for up to 30 years or more. *See* WPP St. 4 at 7; WPP St. 5 at 3-4, 6, 7, and 11-14.

Each EEPA sets forth certain milestone dates that the parties agreed had to be met in order for the purchase rates to remain valid. The purchase rates were based on specified contract terms and specified in-service dates selected by MEI and North Branch. Tr. at 89. The in-service date for Milesburg was expected to be no later than March 31, 1990 (presumably extended to September 30, 1990 by the Consent Order), and for Burgettstown was expected to be no later than October 1, 1991. AAL Ex. 11, Section 2.1; AAL Ex. 24, Section 2.1. Neither project could qualify for the full capacity credit (the Capacity Cost Rate) prior to these expected in-service dates, even if the project began generating energy earlier. *See* Sections 1.2 and Section 9.1 of the EEPA.[17]

The parties agreed that in order for the in-service date to be met, the financing of the project would have to be closed (and the construction of the project therefore presumably commenced) no later than a date sufficiently in advance of the in-service date to allow a minimum amount of time for construction of the project. Tr. at 1439. This date (or "financing deadline") was September 1, 1988 (extended by the Consent Order to February 28, 1989) for Milesburg, and October 1, 1989 for Burgettstown. The actual targeted date for closing financing and beginning construction, of course, was several months earlier, since normal construction lead times are somewhat longer than the minimum construction time. Tr. at 1439.

---

[17] Unless otherwise noted, references below to Section numbers of the EEPA's apply to both EEPA's.

Meeting the financing deadline was a *condition* to each party's obligations under the contract. The unwillingness of both parties to continue to be contractually bound if the financing deadline was not met was clearly set forth in Section 5.7 of the EEPA:

> The obligation of Buyer to purchase from Seller, and of Seller to sell to Buyer, Project Energy hereunder is subject to the condition that the Financing Closing Date shall have occurred on or before [September 1, 1988 for Milesburg; October 1, 1989 for Burgettstown].

AAL Ex. 11, Section 5.7; AAL Ex. 24, Section 5.7.

In addition, Section 10.2 of the EEPA made clear that failure to meet the financing deadline resulted in automatic termination of the contract, relieving each party of its contractual obligations:

> If the Financing Closing Date shall not occur prior to September 1, 1988 *for any reason whatsoever, including Force Majeure,* this Agreement shall *automatically* terminate, in which case neither party shall have any further liability to the other hereunder.

Section 10.2 of the Milesburg EEPA, AAL Ex. 11, Section 10.2 (emphasis supplied). The Burgettstown EEPA is similar:

> If . . . (iii) the Financing Closing Date shall not occur prior to October 1, 1989 *for any reason whatsoever, including Force Majeure,* then Buyer shall have the right to be paid and retain the Good Faith Deposits then held (including interest earnings thereon) (or, in the case of the letter of credit, draw it in full) and this Agreement shall *automatically* terminate without further liability of either party to the other.

AAL Ex. 24, Section 10.2(c) (emphasis supplied).

"Force Majeure" is defined in Section 9.1 of the EEPA as an occurrence that a party is unable to prevent or overcome despite all reasonable efforts, but specifically excludes lack or unavailability of money or changes in market conditions. Therefore, an increase in construction costs that rendered the project no longer feasible could not be a Force Majeure excuse.

If the Financing deadline was met, further milestones also had to be met in order for MEI or North Branch ("Seller") to qualify for capacity credits. Section 2.1 of the EEPA sets forth the Seller's obligation to proceed diligently to design, construct and place the project in commercial operation at the Contract Output (the amount of output qualifying for a capacity credit) on or about the project's scheduled in-service date. Although WPP incorporates the project's in-service date in its generation plans, it was agreed that WPP could not immediately take action to terminate the EEPA if the date was not met. Tr. at 1446-1449. Rather, if the project was not in commercial operation by an agreed deadline (or "termination date"), WPP could elect to terminate the EEPA.[18] The termination date was July 1, 1991 for Milesburg (presumably extended to December 31, 1991 by the Consent Order) and October 1, 1992 for Burgettstown. AAL Ex. 11, Section 10.2; AAL Ex. 24, Section 10.2 (a). The amount of time between the in-service date and the termination date was negotiated based on the project's timetable and how it fit into WPP's generation plans.[19]

[18] The termination date in these contracts was approximately 12 months after the in-service date to allow for the difficulties of coordinating construction schedules, the realities of construction delays and the fact that, after the Financing Closing Date, third party lenders who advanced funds for construction would be relying on the credit of WPP's obligations under the EEPA to support permanent "take out" financing. Tr. at 1446-1449.

[19] WPP negotiates different termination dates depending upon how close the project's scheduled in-service date is to WPP's planned need for capacity. *See* Kave testimony, Tr. at 1440.

Under the terms of the EEPA, the termination date could be extended for an agreed period of time by the Seller, but because the harm to WPP of not receiving the project's capacity increases significantly with time, this could only be done by making monthly payments to WPP to compensate it for harm suffered by additional delays. WPP St. 5 at 7. Each EEPA sets forth an outside date (or "final termination date") by which the project must be in commercial operation or WPP can terminate the contract. This date was July 1, 1992 for Milesburg (presumably extended to December 31, 1992 by the Consent Order) and October 1, 1993 for Burgettstown. AAL Ex. 11, Section 10.2; AAL Ex. 24, Section 10.2(a). The final termination date, like the financing deadline, is a "drop dead" date that, under the terms of the contract, cannot be extended for any reason whatsoever, including Force Majeure.

The Burgettstown EEPA incorporated additional provisions designed to protect WPP from the risks of delays in the construction of the project capacity on which it was relying for planning purposes. Pursuant to Section 10.2(b) of the Burgettstown EEPA as amended [20], North Branch is required to make the following Good Faith Deposits:

October 1, 1988	$ 50,000
January 1, 1989	$ 50,000
April 1, 1989	$100,000
July 1, 1989	$360,000

The last two installments are not required if the Financing Closing Date occurs before the date the installment is due. *See* WPP Ex. 14; AAL Ex. 24, Section 10.2(b). Good Faith Deposits are to be used to make an initial

[20] This Section was amended by an Amendment dated as of October 1, 1988. *See* WPP Ex. 14. Prior to the Amendment, North Branch had been required under the EEPA to make Good Faith Deposits of $140,000 each on October 1, 1988; January 1, 1989, April 1, 1989, and July 1, 1989. AAL Ex. 24, Section 10.2(b).

deposit into an operating and maintenance Reserve Fund. *See* AAL Ex. 24, Section 10.2(d). Pursuant to Section 10.2(c), however, the EEPA automatically terminates if any Good Faith Deposit is not made on the date due, and the amount of any Good Faith Deposits previously made is forfeited. AAL Ex. 24, Section 10.2(c).

The Good Faith Depoits, therefore, function as an option. If North Branch was unwilling to take any further risks of development (including the uncertainty of regulatory delays), it simply could elect not to make a Good Faith Deposit, thereby terminating the EEPA and limiting its liability to Good Faith Deposits, if any, previously made. On the other hand, if it wished to "buy" more time, it could make the next installment due, but such installment would clearly be at risk. North Branch has made all Good Faith Deposits, other than the installment which is due on July 1, 1989, Tr. at 1441, and certainly knew by October 1, 1988 of the regulatory uncertainties affecting its project. It knowingly and openly assumed those risks by making each of the first three Good Faith Deposits.

Any monies spent by MEI or North Branch on project development prior to the financing deadline, and specifically during the pendency of these proceedings, was entirely at their own risk, and certainly not in reliance on any assurance that the EEPA would remain valid and in full force and effect, whether modified or not, beyond the financing deadline. The risks borne by the developers included all risks of regulatory delays.

* * * *

APPENDIX M

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17120

Docket No: P-870216, P-880283, P-880284, P-880286

Public Meeting—September 21, 1989
SEP-89-ALJ-124 *

PETITION OF WEST PENN POWER COMPANY (WPP) FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS (EEPAs) AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS RE: MILESBURG ENERGY, INC.; MONONGAHELA LOCK & DAM NO. 8; BURGETTSTOWN PROJECT AND SHANNOPIN MINE PROJECT

MOTION OF CHAIRMAN BILL SHANE

Before the Commission for disposition is Administrative Law Judge (ALJ) Larry Gesoff's Recommended Decision in the above captioned proceedings.

After thoroughly reviewing the ALJ's Recommended Decision (R.D.) and the Exceptions and Reply Exceptions filed thereto, I believe we should adopt the ALJ's Recommendation regarding "Phase I" issues, with minor modification, and reverse the ALJ's recommendations concerning "Phase II."

Phase I

1. *The reasonableness of rates in negotiated contracts generally is to be judged by a comparison to rates that would be required under the Commission's regulations. R.D. at 38-41.*

This is a fundamental concept that has been the basis for all of the Commission's Orders approving rate recovery of amounts to be paid to Qualifying Facilities (QFs) under negotiated agreements. The methodology in the Commission's regulations is binding upon all in Pennsylvania unless and until the Commission revises it as a result of the general investigation at Docket No. I-860025.

This finding should be adopted *and strengthened* by a more vigorous defense of the capacity credit formula at 52 Pa. Order § 57.34(c).

2. *The reasonableness of the capacity credits in the instant proceedings is to be judged by a comparison to rates that would be required under West Penn's methodology, R.D. at 41-42.*

The only evidence regarding credits under Commission's regulations submitted in the instant proceeding was testimony by West Penn witness Kave. All parties are in basic agreement that West Penn's methodology is appropriate, although various "inputs" into the methodology were challenged. Therefore, as a practical matter, I believe that the ALJ's finding in this issue be adopted, with the *addition of express language* noting that West Penn's methodology results in lower capacity credits than an application of the Commission's regulations; therefore, since credits under the Commission's regulations would be *per se* reasonable, it follows that credits calculated under West Penn's methodology are *per se* reasonable as well.

3. *West Penn's avoided costs are to be determined as of the time that agreement in principle on rates was reached, which meets the definition of "serious negotiations", R.D. at 44-52.*

The Commission should adopt this portion of the R.D. as written, with the *addition of a caveat* that, if the evidence in this proceeding had demonstrated that West Penn had unreasonably delayed the issuance of project price proposals, the time frame of "serious negotiations" would

have been set as prior to the agreement in principle in rates. It is important that the Commission reiterate its position on time frame in a manner that prevents utilities from depriving QFs of avoided costs rate entitlement by delaying negotiations (see R.D. at 50).

4. *West Penn's projection that the next avoided unit would be a 300 MW base load coal unit, as opposed to a combustion turbine, was appropriate, R.D. at 71-80.*

The Commission should adopt this portion of the ALJ's R.D. with the *addition of language* at p. 80 *affirmatively stating* that the Commission agrees with West Penn that Allegheny Power System's (APS) load factor in conjunction with the volatility in the supply and price of natural gas and oil, the availability of economical sources of coal, and the public policy in Pennsylvania of encouraging the use of coal, supported West Penn's decision to add a coal unit as its next generating resource.

5. *Section 527 of the Public Utility Code does not mandate discounts from the full avoided cost standard of PURPA 210, R.D. at 95-97.*

The Commission should adopt the ALJ's R.D., with *language strengthening the conclusion.* Armco/Allegheny have in the past made superficially appealing but groundless arguments such as the Section 527 argument raised in this proceeding. I believe that strengthening this discussion is advisable.

6. *West Penn is directed to make a demand energy allocation of capacity charges as part of its next ECR filing, R.D. at 101-105.*

This rate structure issue is one that the Commission will have to address in the near future for all electric utilities that are flowing or that will begin to flow significant costs paid to QFs through the Energy Cost Rate (ECR) mechanism. The ECR mechanism allocates costs for fuel and purchased power strictly on an energy, or kwh, basis.

Whenever purchased power costs include payments for QF capacity, the ECR recovery mechanism is biased against high load factor, energy-intensive ratepayers (usually industrial ratepayers). If *utilities* build generating units and capital costs were recovered through *base rates,* costs would be allocated to customer classes on a demand/energy basis. Therefore, as utilities in the future begin to substitute purchases from independent power projects for their own construction, the rate structure issue takes on added importance. Ratepayers should remain indifferent to the source of supply as far as the allocation of costs is concerned. Thus far, arguments before the Commission in other ECR proceedings by industrial customers on this issue have received scant attention and met with little success. *See, e.g., Andrezeski v. Pennsylvania Electric Company,* Docket No. M-870172C001 *et seq.* (August 5, 1989) demand reallocation not appropriate at this time because demand component in Penelec's ECR is not large yet)*; GPU Industrial Intervenors v. Metropolitan Edison Company* Docket No. M-870171C001 (August 15, 1989) (demand reallocation denied based on several factors and confusion regarding GPUII's proposals).

The ALJ's discussion up to the middle of page 104 should be adopted. However, the ALJ's statement at the beginning of the paragraph that the costs in question "will not be recovered through WPP's ECR until the next ECR proceeding" is in error. The costs in question will not be recovered for several years, after the projects are financed and constructed. Therefore, rather than ordering West Penn to make a demand/enegy allocation in the next ECR filing, I believe that the Bureau of Audits, with assistance from the Law Bureau, should be directed to prepare a recommendation for a future public meeting regarding the opening of a separate proceeding to address the rate structure issue. Depending on this recommendation, the Commission could issue a proposed regu-

lation applicable to all utilities *or* open a formal investigation into West Penn's ECR mechanism. Without input from Audits, I am unsure whether this issue should be handled generally or on a company-specific basis.

Phase II

A. *Milesburg*

The original financing date in Milesburg's contract of September 1, 1988 was extended to February 28, 1989 by a Consent Order signed by all parties and entered by the Commission on September 1, 1988. On February 8, 1989, Milesburg filed a Petition under Section 508 of the Public Utility Code, 66 Pa. C.S. § 508, requesting that (1) the financing date be extended to 120 days after a final and nonappealable Commission Order approving rate recovery, and (2) the capacity credit be increased from 3.3¢/kwh to 4.9¢/kwh to reflect the delay in the project's in-service date. Milesburg cannot go forward without an extension of the financing date, and avers that, since construction costs and interest rates have risen over time, the 3.3¢/kwh capacity credit can not longer support the project.

The ALJ recommended that Milesburg's Section 508 Petition be denied based on his finding that the contract between Milesburg and West Penn no longer exists due to the passing of the financing date. R.D. at 110-118. With respect to the request for an increase in the capacity credit, the ALJ found that the September 1, 1988 Consent Order specifically barred a capacity credit higher than that set forth in the contract. With respect to Milesburg's argument that the legally enforceable obligation of West Penn under PURPA 210 does not depend on the existence of a contract, the ALJ agrees, but states that "MEI must file a petition with the Commission to set rates as of the time of serious negotiations *under the provisions of the Commission's PURPA regulations*". R.D.

at 117 (emphasis in original). The ALJ concludes that, "[d]espite the obvious equities in favor of the MEI Project, the [contract] does not exist and cannot be approved." R.D. at 117. The ALJ recommends that West Penn's and Armco/Allegheny's petitions to withdraw/dismiss the Milesburg contract rate recovery petition be granted.

In my opinion, the ALJ's recommendation on these issues is in error, both legally and from a public policy perspective. First, regardless of whether or not the 1987 contract has lapsed, Milesburg is entitled to sell power to West Penn at rates based on West Penn's avoided cost projections in effect at the time of serious negotiations, as discussed above. Milesburg, which has been endeavoring to obtain a Commission Order approving rate recovery since April 1987, has done nothing to waive entitlement to these rates. The rates requested by Milesburg are rates calculated under West Penn's methodology, which (1) results in lower rates than the methodology in the Commisison's regulations and (2) is the appropriate methodology for determining avoided costs in this proceeding, as per the agreement of the parties and the ALJ recommendation. It therefore follows that if Milesburg is entitled to, for example, 6¢/kwh under the regulations, it is entitled to a *lesser* amount under West Penn's methodology. The fact that Milesburg has not attempted to invoke the capacity credit methodology in the Commission's regulations means that ratepayers will pay *less* for Milesburg power than would otherwise be required. Rather than require Milesburg to initiate a separate proceeding to seek *higher* rates, as the ALJ recommended, the Commission should require West Penn to execute a new contract with Milesburg, identical in most respects to the lapsed 1987 contract, with the financing date set six months after the receipt of a final and nonappealable Commission Order, with similar extensions to related milestones. It simply does not make sense to hold that Milesburg must initiate a new proceeding to seek rates

higher than the rates it has requested. Moreover, Milesburg already has been before the Commission and Commonwealth Court for 2½ years. In my opinion, requiring Milesburg to start over with a separate evidentiary proceeding likely would result in the abandonment of the Milesburg Project.

With respect to the rate determination, it is my opinion, first, that West Penn's methodology should be utilized, as modified by the additional calculation reflecting monthly, as opposed to annual, payments discussed above. This conforms with the ALJ's R.D. in Phase One at pp. 97-100. Very simply, West Penn "fine-tuned" its methodology between execution of the Milesburg contract and the other three contracts at issue in this proceeding. This refinement should be incorporated because the Commission would be ordering the execution of a *new* contract if this motion is adopted. Therefore, the newer format should be utilized. This refinement has the effect of lowering the rates paid to Milesburg.

Second, the "in-service date" of Milesburg (an input into West Penn's methodology) should be moved forward to 30 months after the receipt of a final, nonappealable Commission Order in this proceeding. Because we do not know if our Order will be appealed, or how long it will take to resolve any appeals that are filed, the particular capacity credit cannot be determined precisely at this time. However, *when* the projected in-service date is known, calculating the resulting credit is simply a mathematical exercise using West Penn's methodology.

This recommendation has the effect of increasing Milesburg's capacity credit because West Penn's methodology places a higher value on capacity that more closely matches West Penn's need for capacity in 1995. This is the reason, for example, that Shannopin's capacity credit of 4.0¢/kwh is higher than the other capacity credits at issue in this proceeding. The 30-month period after a final nonappealable Order is recommended (for estab-

lishing an in-service date) by deducting the six-month extension agreed upon by all parties to the Consent Order of September 1, 1988 from the estimated financing and construction period of 36 months.[1] Although the ALJ concluded that the Consent Order barred any increase to the capacity credit, in my opinion the Consent Order was intended merely to deny any increase based on the six-month extension that was agreed upon. In other words, a reasonable interpretation of the Consent Order is that the *quid pro quo* for getting parties to agree to the limited six-month extension was Milesburg's agreement not to seek a capacity credit increase based on that particular six months.

In my opinion, it is essential that the Commission recognize and reflect regulatory delay in its Order. Project financing is very time sensitive because a project's capital costs are constantly increasing as time goes by. If a project is stuck with fixed rates as its costs go up, the project's internal rate of return will decline to the point that the project cannot be financed. Should the Commission fail to make adjustments for time delays, the Milesburg project likely will be abandoned. Perhaps more importantly, the Commission will be inviting interventions in opposition to future rate recovery proceedings because intervenors will know that they can win by default regardless of the merits of their position. In essence, intervenors will be able to kill future QF projects simply by filing answers in opposition to rate recovery petitions and taking the projects into a lengthy hearing and appellate process. This will be the exact result of the instant proceeding with respect to Milesburg if the Commission fails to make adjustments for regulatory delay, despite the clear findings of the ALJ (and presumably the Commis-

[1] Milesburg estimated that construction would take 30-36 months; adding six months for financing to the lowest estimate for construction of 30 months equals 36 months.

sion) that the project is beneficial to ratepayers and to Pennsylvania and the equities are on the side of the QF.

Additionally, although the nominal capacity rate will increase, the rates in real terms will not increase as much due to the time value of the money and the delayed in-service dates. Secondly, the resulting capacity credit is merely the capacity credit that would have resulted from an application of West Penn's methodology *if* the parties could have anticipated the delayed in-service date resulting from the extensive litigation in this proceeding. West Penn's methodology is a conservative methodology for calculating avoided costs; hence the capacity credits calculated by the methodology likewise are low. Therefore, even with an adjustment to the in-service date, obtaining firm baseload capacity at a fixed rate of, for example, 5¢/kwh is a bargain compared to rates that would be paid for utility-built capacity.

For all of the foregoing reasons, the ALJ's recommendation regarding Milesburg in Phase Two of this case should be reversed.

B. *Burgettstown*

North Branch's April 5, 1989 Section 508 Petition similarly requests modification of milestone dates and increased capacity rates to reflect the delay in the in-service date for the Burgettstown Project. North Branch filed an Application for Stay on August 21, 1989 which was the subject of a 2-2 (no action) vote at the Public Meeting of August 31, 1989. On September 8, 1989, North Branch filed a Motion for Reconsideration and Amendment to its Exceptions to the ALJ's R.D. The Amendment withdraws North Branch's request for an increase to the capacity credit. Therefore, the Phase Two issues remaining before the Commission are:

1. The request to modify milestone dates set forth in the April 5 Section 508 petition.

2. The August 21 Application for Stay.

3. The September 8 Motion for Reconsideration.

The latter two issues, of course, post dated and therefore were not ruled upon by the ALJ's R.D.

For the reasons set forth in the previous discussion of Milesburg's Phase Two issues, I suggest that (1) the milestones be extended under Section 508; and (2) the Application for Stay of the financing closing date be granted. To do anything but to grant the stay and order the milestone extensions would make no sense, unless the Commission had decided to change its policy of encouraging the development of cogeneration and small power production. As North Branch states in its Motion for Reconsideration, failure to stay the financing closing date will result in automatic termination of its contract without any consideration of the merits, merely because of the length of time it has taken to complete this proceeding.

THEREFORE, I MOVE: That the Commission adopt an Opinion and Order consistent with all of the foregoing, modifying the Administrative Law Judge, Larry Gessoff's Recommended Decision regarding Phase I issues as discussed above and reverse the ALJ's Recommended Decision on Phase II issues, thereby granting extensions to Milestone dates for the Milesburg and Burgettstown Project and increasing the capacity rate for the Milesburg Project.

/s/ Bill Shane
BILL SHANE
Chairman

DATED: 9/20/89

Public Meeting of September 21, 1989

STATEMENT OF COMMISSIONER FRANK FISCHL

RE: WEST PENN POWER COMPANY PETITIONS
P-870216, P-880283, P-880284, P-880286
AUG-89-ALJ-124

I AM OPPOSED TO THE MOTION BECAUSE IT IS DETRIMENTAL TO WEST PENN RATEPAYERS AND IN SOME CASES BEYOND THE AUTHORITY OF THIS COMMISSION.

THE CAPACITY CREDITS REQUESTED ARE CLEARLY ABOVE WEST PENN POWERS' AVOIDED COSTS.

AS TO THE CONTRACT ISSUES, OUR REGULATIONS CLEARLY STATE NONINTERFERENCE WITH FREELY NEGOTIATED CONTRACTS. THE ALJ CORRECTLY CONCLUDED THAT IF THE DEVELOPERS ARE PERMITTED TO MODIFY THE NEGOTIATED ELECTRIC ENERGY PURCHASE AGREEMENTS BECAUSE OF UNFORESEEN EVENTS, THE CONTRACTS BECOME MEANINGLESS.

I; THEREFORE, VOTE *NO*.

September 21, 1989
DATE

/s/ Frank Fischl
FRANK FISCHL
Commissioner

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, Pa. 17120

Public Meeting September 21, 1989

Docket No. P-879210, P-880283, P-880284, P-880286
ALJ—124

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF EEPA FOR MILESBURG *et al.*

STATEMENT OF COMMISSIONER
JOSEPH RHODES, JR.

Mr. Chairman, I intend to support your motion for the resolution of the EEPA's of West Penn Power that are before us today, though I do so with considerable reluctance. In essence we are abrogating bona fide contracts that were willingly entered into by all parties. As anyone who has negotiated a contract would attest: a closing date is a crucial negotiated element of any contract. Time is money; and even more so when we are talking about electric utilities with long lead times associated with constructing generating facilities. What your motion does is to increase the certainty associated with PURPA projects for the developer and to decrease it for utilities.

What persuades me to support your motion is that the delays associated with these projects stem from extended litigation before Commonwealth Court and this Commission. I would, however, consider this action today to be the exception not the rule. "Once burned, shame on you; twice burned shame on me."

It would seem prudent that current and future QF project negotiations should anticipate the possibility that protracted litigation will delay the closing date for the project. Contracts should be sufficiently robust to take this into account. Of course, there is no free lunch. What I'm talking about is a kind of insurance with a schedule of power costs that reflect the slippage of time. Utilities should not have to provide this for free.

If such contingency provisions are not part of a QF contract and the closing date slides for any reason, this Commissioner will assume that the parties declined to take out the insurance policy and just got burned.

9-21-89
Date

/s/ Joseph Rhodes, Jr.
JOSEPH RHODES, JR.
Commissioner

APPENDIX N

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held September 21, 1989

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice Chairman
Joseph Rhodes, Jr.
Frank Fischl, dissenting

Docket Nos.
P-870216
P-880283
P-880284
P-880286

PETITIONS OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASE POWER COSTS

Re: MILESBURG ENERGY, INC.
MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

ORDER

BY THE COMMISSION:

Before us for consideration is the Recommended Decision ("R.D.") of Administrative Law Judge Larry Gesoff ("ALJ") issued June 27, 1989 in the above-

captioned consolidated proceedings, as well as the Exceptions and the Reply Exceptions filed by the various parties. Also before us is the Application for Stay of Proceedings and Motion for Reconsideration filed by North Branch Energy Partners, L.P. ("North Branch") on August 21, 1989 and September 12, 1989, respectively, at Docket No. P-880284, as well as various responsive pleadings thereto. For the reasons stated more fully below, we will (1) grant West Penn Power Company's ("West Penn") petition at Docket No. P-880283 for approval of the Electric Energy Purchase Agreement ("EEPA") with Noah Corp., the developer of the Monongahela Lock & Dam No. 8 Project; (2) grant West Penn's petition at Docket No. P-880286 for approval of the EEPA with Mon Valley Energy Corp. ("Mon Valley"), the developer of the Shannopin Mine Project; (3) grant West Penn's petition at Docket No. P-880284 for approval of the EEPA with North Branch, the developer of the Burgettstown Project, while granting North Branch's Petition for Modification and Application for Stay with respect to the Financing Closing Date and related milestones in its EEPA; and (4) require West Penn to execute a new EEPA with Milesburg Energy, Inc. ("Milesburg"), similar in terms and conditions to Milesburg's 1987 EEPA but with modifications to the Financing Closing Date and related milestones and revisions to the capacity credit, grant approval of the revised EEPA, and deny West Penn's petition to withdraw its rate recovery petition. With respect to the rate structure issue raised in this proceeding, we find merit in the concept of allocating capacity charges to customers on a demand/energy basis through West Penn's Energy Cost Rate ("ECR") mechanism. However, rather than requiring West Penn to modify its ECR in its next annual filing, we will open a separate proceeding to consider modifications to West Penn's ECR after receipt of an advisory report from our Bureau of Audits.

BACKGROUND

The long history of these proceedings was fully described at pp. 1-32 of the ALJ's R.D., which we will incorporate by reference herein.

Following issuance of the ALJ's R.D. on June 27, 1989, Exceptions were filed by Milesburg, North Branch, the Office of Consumer Advocate ("OCA"), and Armco Advanced Materials Corp./Allegheny Ludlum Corp. ("Armco/Allegheny"). The West Penn Power Industrial Intervenor's ("WPPII")[1] filed a letter stating that it did not intend to file Exceptions to the ALJ's R.D. Reply Exceptions were filed by West Penn, OCA, WPPII, Armco/Allegheny and jointly by North Branch, Milesburg, and Mon Valley.

On August 21, 1989 North Branch filed an Application for Stay of Proceedings with respect to the Financing Closing Date of October 1, 1989 in its EEPA. West Penn filed an Answer and Armco/Allegheny filed a Protest opposing North Branch's Application on August 25 and August 28, respectively. On September 12, 1989 North Branch filed an Amendment to its Exceptions, thereby withdrawing its request for modification to its capacity rates, and a Motion for Reconsideration. Answers to the Motion for Reconsideration were filed by West Penn and Armco/Allegheny on September 15 and September 13, respectively. North Branch filed a Response to West Penn's Answer on September 19, 1989.

Our decision of today's date addresses the merits of the issues raised in these consolidating proceedings and grants North Branch's Application for Stay.

---

[1] WPPII is an ad hoc group of industrial customers comprised, in these proceedings, of Airco Industrial Gases, Latrobe Steel Co., National Roll Co., Pennsylvania Pressed Metals, Powder Metal Products, Inc., and PPG Industries, Inc.

DISCUSSION

We will address the issues raised in this proceeding seriatim by reference to the ALJ's R.D. regarding each issue, which we incorporate by reference herein, and the Exceptions and Rely Exceptions thereto. A discussion and ruling on the North Branch Application for Stay will follow. Phase I of the proceeding generally addresses the reasonableness of the capacity credits set forth in the various EEPAs as well as the rate structure issue regarding the methodology by which the capacity costs paid by West Penn to developers of qualifying facilities ("QFs") should be recovered from ratepayers. Phase II of the proceeding addresses issues raised by the lengthy delay in the approval process to which the EEPAs have been subjected.

A. PHASE I.

1. *The Legal Standard to be Applied; R.D. 32-42.*

The ALJ rejected the arguments of Armco/Allegheny and OCA that the Commission's regulations cannot be used as a benchmark to assess the reasonableness of capacity rates in negotiated contracts. Rather, the ALJ concluded that, if negotiated rates are at or below the rates to which a QF would be entitled as a matter of law (i.e., as defined by the Commission's regulations), the rates are *per se* reasonable. The ALJ rejected the collateral attack by Armco/Allegheny and OCA on the Commission's regulations, stating that they are in full force and effect unless and until they are modified by the Commission or invalidated by the Commonwealth Court. Nevertheless, the ALJ concluded that, due to the nature of the evidence in this record, in these proceedings the reasonableness of the various capacity credits should be measured against West Penn's methodology as opposed to the Commission's regulations.

Milesburg excepts to the ALJ's conclusion that, due to the evidence in this record, the Commission's regulations

cannot be used as the benchmark in these proceedings. Milesburg states that West Penn's witness introduced the calculations under the regulations into the record on behalf of the parties to this proceeding, and that whether West Penn or other parties are critical of the regulations is irrelevant. Milesburg notes that the Commission consistently has held that its regulations should serve as the standard against which the reasonableness of rates in an EEPA are to be evaluated.

North Branch excepts to this portion of the ALJ's R.D. as well, noting that West Penn's witness stated on the record that West Penn's avoided cost filing of July 31, 1986, which reflected a capacity credit for 1991 of 4.85 cents per kwh, represented West Penn's best estimate of its avoided costs based on its interpretation of the regulations. North Branch states that the ALJ erred in disregarding the calculations based on West Penn's opposition to and collateral attack of the regulations.

OCA excepts to the portion of the R.D. that states that calculations under the Commission's regulations could serve as a proper benchmark against which the reasonableness of the capacity credits could be measured based on OCA's argument that the Commission's regulations do not employ discounting and therefore violate Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S. § 824a-3 ("PURPA 210").

West Penn's Reply Exceptions at p. 2 state that "[n]o party has challenged the formulas developed by [West Penn] for computing avoided cost, which produce a lower avoided cost figure than under the Commission's own regulations, but rather only the inputs used in the formulas." West Penn states that it is not necessary in this case to choose between West Penn's and the Commission's methodologies because, except for a minor adjustment to the Milesburg calculation, use of either methodology results in approval of the contract rates as being at or below avoided costs.

North Branch, Milesburg and Mon Valley, jointly filed Reply Exceptions ("Projects' Reply Exceptions") stating that OCA's criticism of the Commission's regulations should be given no consideration in these proceedings.

OCA's Reply Exceptions state, *inter alia*, that the ALJ's recommendation not to apply the Commission's regulations was not based on West Penn's criticisms, but on the lack of an adequate evidentiary foundation for their consideration. OCA states that the Projects had an opportunity to file answering testimony and alternate calculations. OCA argues that the testimony of West Penn witness Kave and West Penn's 1986 avoided cost filing were not sufficient evidence.

Armco/Allegheny's Reply Exceptions state that, since the R.D. assessed the various capacity credits based on West Penn's methodology, it makes no difference that the R.D. did not compare the capacity credits to rates derived under the Commission's regulations. Armco/Allegheny argue that the regulations are ambiguous and produce rates in excess of avoided costs; that West Penn's avoided cost filings apply only to QFs of 500 kw or less; and that the QFs in this proceeding are not automatically entitled to capacity rates set forth in annual avoided cost filings.

On this issue, we adopt the ALJ's recommendation. The reasonableness of rates in negotiated contracts generally is to be determined by a comparison to rates that would be required by an application of the Commission's regulations. This is a fundamental concept that has been the basis for nearly all of the Commission's Orders approving rate recovery of amounts to be paid to QFs under negotiated agreements. The methodology in the Commission's regulations is binding upon all in Pennsylvania unless and until the Commission revises it as a result of the generic investigation at Docket No. I-860025 or otherwise. We find no merit in arguments that our regulations overstate a utility's avoided costs. State regulatory com-

missions have been granted a substantial degree of latitude in the implementation of PURPA 210, and avoided costs are *defined* by our regulations. In other words, our regulations determine what a utility's avoided costs are under the law, notwithstanding arguments that a different methodology or methodologies might be preferable. The possibility that our regulations may not be perfect in some party's view is irrelevant. The regulations were finalized in January 1983 after an extended notice and comment period in a proceeding where all interested parties had the opportunity to make their views known. Although we may refine our regulations as a result of our generic investigation, in our view the regulations are basically sound. In particular, our coal proxy regulation at 52 Pa. Code § 57.34(c) recognizes the fact that logically the next base load unit for a utility in Pennsylvania that is anticipating a need for additional base load capacity would be a coal plant. By basing capacity credits on a capital-intensive unit with relatively stable associated energy credits, the coal proxy regulation encourages the development of capital-intensive qualifying facilities such as those that are fueled by coal or coal waste. From both a ratepayer and a public policy perspective, in our view it is important that our regulations under PURPA 210 permit continued development of coal and coal waste facilities.

Nothwithstanding the fact that generally avoided costs are to be determined by application of our regulations, we agree with West Penn that it is not necessary in this proceeding to choose between West Penn's and the Commission's methodologies because use of either methodology results in approval of the contract rates. All parties agree that West Penn's methodology produces rates that are lower than rates produced by the Commission's regulations. None of the Projects have requested rates calculated under the regulations. Therefore, as a practical matter, we adopt the ALJ's recommendation to utilize West Penn's methodology as the benchmark for determin-

ing West Penn's avoided costs in these proceedings. Since rates calculated under our regulations would be *per se* reasonable, and West Penn's methodology produces lower rates, it follows that rates calculated under West Penn's methodology (assuming the inputs are appropriate) are *per se* reasonable as well. Our decision on this issue also renders it unnecessary to resolve any ambiguities that may exist in our regulations at this time.

2. *Burden of Proof, R.D. at 42-44.*

The ALJ concluded that under Section 332(a) of the Public Utility Code, 66 Pa. C.S. § 332(a), West Penn has the burden of proof in these proceedings as the proponent of an Order. The ALJ states that West Penn must meet its burden of proof by substantial evidence. No party filed an exception to this conclusion. We adopt the ALJ's recommendation on this issue.

3. *Time Frame, R.D. at 44-52.*

With respect to the time frame that will be utilized to determine West Penn's avoided costs, the ALJ recommended adoption of West Penn's agreement in principal on rates as the time of serious negotiations under the Commission's standard set forth in *Pennsylvania Public Utility Commission v. Duquesne Light Company,* Docket No. R-860556 (July —, 1987). Agreement in principle on rates was reached in April 1985, May 1986, September 1986, and October 1986 for the Monongahela, Milesburg, Shannopin and Burgettstown Projects, respectively.

The only party to file an exception to this recommendation was Armco/Allegheny, which argue that the date that the EEPAs were executed should be utilized. Armco/Allegheny state that two tax changes occurred prior to the contract signing dates that should be incorporated into the calculation of the capacity credits for the Milesburg, Shannopin and Burgettstown Projects, namely the Tax Reform Act of 1986, signed into law October 22, 1986

and effective in tax years 1987 and beyond, and a reduction in the Pennsylvania Corporate Net Income Tax effective January 1, 1987. Armco/Allegheny argue that the dates of contract execution (February 25, 1987 and October 15, 1987) are the earliest dates that the serious negotiations standard should be deemed satisfied because these were the dates the Projects were legally committed.

West Penn's Reply Exceptions state that the issue is whether West Penn's use of time of agreement in principle to determine avoided costs was reasonable. West Penn notes that Armco/Allegheny offered no witness with experience in negotiating QF contracts or with experience in financing such contracts; witnesses with such experience were West Penn's chief contract negotiator; representative of the Projects, and a Vice-President of Mellon Bank with considerable experience in project financing. West Penn states that the testimony of these witnesses demonstrates that calculation of avoided costs at the time of agreement in principle on rates is critical to encourage and stabilize the process of voluntary negotiation of contracts under PURPA, since the developer of a QF needs rates upon which it can rely in evaluating the potential feasibility of a project. Typically, a developer has only limited available resources and has to borrow between 75% and 85%, and sometimes more, of the funds necessary to construct a facility. Usually this money is loaned without recourse to any assets other than the project itself; therefore, lending institutions must rely on the revenue stream generated by the sales of power to repay the debt. As a result, substantive evaluation of project financing cannot be made until the qualifying facility and the utility have agreed upon a particular rate. An up-front evaluation of economic feasibility is important because often the substantial investment to lay the groundwork for a project is not possible without some assurance that the project is economically feasible. If West Penn were not able to agree to purchase rates until a contract is

signed, the QF could get all the way to final contract negotiations only to find the avoided costs for capacity have dropped. West Penn states that, although a broad "serious negotiation" standard creates problems for a utility, West Penn's selection of a specific point during negotiations (agreement in principle) is consistent with the intent of the serious negotiation standard. In calculating avoided costs for these contracts, West Penn selected a specific time during the negotiation process at which its risk of relying on a project's capacity for planning purposes is significantly reduced. West Penn states that Armo/Allegheny's argument on this point applies hindsight because, in this case, lower rates would result. However, avoided costs just as easily could have increased.

The Projects' Reply Exceptions state that Armco/Allegheny's position on the tax issue in reality is a request that the Commission change its policy on the serious negotiations standard, and that any changes in policy should not be made retroactively. Acceptance of Armco/Allegheny's argument would assume that existing policy is meant to be changed on a case-by-case basis and would seriously undermine the Commission's credibility. The Projects support the Commission's standard because it ensures that negotiated rates will be preserved as negotiations continue; under Armco/Allegheny's proposal developers would be required to petition the Commission for higher rates under the regulations in order to "lock-in" avoided cost estimates. The Projects note that Armco/Allegheny relied solely on the testimony of one witness to support their argument who had no experience in advising parties to QF contracts, had never negotiated a QF contract, and did not consider the effect of his theory on potential developers. Nevertheless, with no experience or background, the witness stated that "[t]he time frame of serious negotiations is completely nebulous and ambiguous. Such a time frame could expanse years of negotiations prior to the signing of a contract." Projects' Reply Exceptions, p. 3. The Projects assert the time frame for

serious negotiations is neither nebulous nor ambiguous, and that each project has identified a specific period, none longer than seven months, during which rates were agreed upon and expenditures were made in reliance thereon. The Projects state that Armco/Allegheny's witness has confused negotiation of rates with negotiation of technical terms and conditions. The Projects refer to testimony that, without a firm commitment on price (1) contractors and engineers are reluctant to provide bids and financing is unavailable; (2) developers would not risk the substantial development costs required to perform essential activities necessary to advance a project from the early feasibility study stage to contract signing; and (3) use of contract execution date would have a chilling effect on cogeneration and small power production. The Projects state that use of hindsight would establish a constantly moving target with respect to avoided capacity rates and could be used by a utility to circumvent the requirement to provide capacity credits to a QF merely by refusing to enter into an EEPA or by delaying execution of an EEPA. The Projects argue that the rates quoted to the Projects were reasonable at the time, and any change thereto would be retroactive policy-making which has never been contemplated by this Commission even in the generic investigation. Finally, the Projects' Reply Exceptions briefly describe the negotiations and project development work that took place for each Project and conclude that each Project satisfied the serious negotiations standard in *Duquesne*. The Projects aver that Armco/Allegheny's proposal is totally unrealstic and cannot result in a negotiated EEPA because an EEPA cannot be executed without the prior completion of substantial development work. With respect to the related tax issue, the Projects state that West Penn correctly applied the tax laws in effect at the time of serious negotiations in the calculation of the Fixed Charge Rate ("FCR"). The Projects' rates were calculated in or before May 1986 while the Conference Report on the Tax Reform Act of

1986 was not issued until September 19, 1986. Thus, it is unreasonable to argue that West Penn should have recalculated its prior firm price quotes after the Projects had expended substantial amounts of money in reliance upon those rates.

On this issue we adopt the ALJ's recommendation, and reiterate our longstanding policy that avoided costs are to be determined as of the time of serious negotiations. Objective criteria are needed and must be applied consistently to give reliability to negotiations between utilities and QFs. Otherwise, avoided cost rates would evolve into a constantly moving target, a phenomenon that would undermine contract negotiations and chill the continued development of cogeneration and small power production facilities. Our policy was formulated in recognition of the fact that a utility's avoided costs could drop; however, a utility's avoided costs just as easily could rise. The ALJ correctly noted that, "[u]ltimately, no matter what time is used to fix EEPA purchase rates, the ratepayers bear a risk that avoided costs will go down after that time and the QF bears the risk that avoided costs will go up." R.D. at 51. For the reasons set forth in the Reply Exceptions of West Penn and the Projects, we find that Armco/Allegheny's argument that time of contract execution should control is without merit. Therefore, we affirm our policy on the serious negotiations standard and accept West Penn's agreement in principle on rates as the time that the serious negotiations standard was satisfied. Our adoption of the agreement in principle on rates is limited to the facts of the instant proceeding since utilities other than West Penn utilize different practices and procedures when negotiating QF contracts. Moreover, if the evidence in a proceeding demonstrated that a utility unreasonably delayed the issuance of project price proposals, the time frame for serious negotiations would be set prior to the agreement in principle on rates. In addition to the need to prevent avoided costs from evolving into a moving target,

there is a need to assure that utilities cannot deprive QFs of avoided cost rate entitlement by delaying negotiations.

4. *The Reasonableness of the Capacity Rates in the EEPAs.*

a. *West Penn's Methodology, R.D. at 52-55.*

The ALJ's description of West Penn's methodology is not a recommendation on a contested issue, and does not require a discussion. Nevertheless, the ALJ's R.D. aptly summarizes West Penn's methodology and the remaining issues in Phase I of these proceedings. Therefore, for purposes of clarity and completeness, we will set forth in full this section of the R.D.

West Penn's methodology for calculating the avoided costs in the EEPAs is set forth in WPP Exhibit 1 and described in WPP Statement 1 at pages 15-20 generally and at pages 20-24 for each Project. West Penn's methodology is included in a report captioned "The Value of Generating Capacity". WPP Ex. 1. West Penn's methodology calculates avoided costs by determining the amount of overlap between the QF's supply of capacity and the APS need for capacity. This overlap shows how much capacity (in months) can be avoided by recognizing the in-service date and economic life of the APS plant as well as the in-service date and contract term of the QF. These avoided costs are spread over the QF contract term as a levelized rate such that the present value of the avoided APS plant costs equals the present value of the payments to the QF. According to Mr. Kave, these equivalent present values ensure that the ratepayers pay no more for QF capacity than the avoided costs of the APS plant, regardless of the in-service date and contract term of the QF. WPP St. 1 at 15-16.

The APS need for generating capacity is determined from the APS Integrated Resource Plan which, for these Projects, shows that new, avoidable generating capacity

would be needed in the form of three, 300 Mw coal-fired units. These units were included as a part of West Penn's annual system cost data filing (52 Pa. Code § 57.33) and the annual resource planning report (52 Pa. Code § 57.49). Mr. Kave states that these units are also consistent with the coal proxy definitions used within the Commission's regulations. WPP St. 1 at 16.

The rates in cents per Kwh will differ among projects depending on the length of the contract term and the QF's in-service date. Generally, the closer a QF's in-service date is to WPP's need for capacity, and the longer the contract term overlaps the life of the avoided plant, the greater the costs are that can be avoided.

Similarly, avoided capacity rates differ depending on when the next APS plant is needed. That is, for a given QF contract term and in-service date, the rate may change if the APS Integrated Resource Plan changes. All other things being equal, the farther into the future the next need for an APS plant, the lower the avoided capacity cost rates will be under APS's methodology. This tends to discourage capacity additions by QFs that are not needed. Conversely, if there is a near term need for capacity, the methodology tends to encourage QF development by offering higher rates. According to Mr. Kave, this sensitivity to forces of supply and demand creates a built-in safeguard against excess capacity problems. WPP St. 1 at 17.

Another reason that capacity rates may differ among projects is that capacity rate calculations are performed using standard APS information and estimates which are available at the time of calculation. Since these calculations are performed at different times, the underlyling information may change. WPP St. 1 at 17.

Capacity rates are normally paid to QFs on a cents per Kwh basis for Kwh's of energy which are scheduled and delivered. This provides a strong incentive for the QF to maximize its availability and deliveries. Under

dispatch conditions the QF is paid a capacity rate for the amount of capacity which is available and scheduled for possible delivery. Under certain conditions of poor performance, such as excessive deliveries during off-peak hours and inability to meet dispatch criteria, the capacity payments to the QF are reduced. WPP St. 1 at 17.

As noted above, West Penn maintains that the EEPA rates are below its avoided costs under either its methodology or the Commission's regulations. No party challenged West Penn's methodology or the calculated energy rate in the EEPAs.

At issue are the correctness of the inputs West Penn used in its methodology regarding the capacity rate calculation. These inputs include the reserve margin, the type of avoided unit used (coal v. combustion turbine), the avoided unit's availability, and the fixed charge rate.

Also at issue is WPPII's assertion that West Penn's capacity rates should be based on the renovated Springdale and Mitchell plants which will come on line before any of the QFs. In addition, OCA argues in favor of a correction to the Milesburg Project avoided capacity costs to reflect monthly payments required by the EEPA. Finally, Armco/Allegheny and WPPII argue for EEPA capacity rates to be passed through to West Penn's ratepayers on a demand/energy basis instead of on an energy basis only. These issues are addressed below.

b. *Reserve Margin, R.D. at 55-71.*

The ALJ recommended adoption of West Penn's planning reserve margin of 25%. Armco/Allegheny and OCA argued for reserve margins of 15% and 20%, respectively. The ALJ's R.D. accurately summarizes the position of each party and is, as stated above, fully incorporated herein by reference. The ALJ concluded that West Penn demonstrated that its planning reserve margin was not out of line with the electric industry throughout the United States and within the North American Reliability Coun-

cil's ("NERC") regional council; that West Penn's high load factors and number of super-critical generating units supported its 25% margin; that West Penn used correct judgment in 1986 that the planning reserve margin should not be changed in response to a then recent improvement in generation availability; and that West Penn used correct judgment in considering potential acid rain legislation as one of several reasons why current availability data might not hold in the future. The ALJ concluded by noting that forecasting a reserve margain requires the use of studies and computer analyses, but the final decision requires informed judgment based on experience. The ALJ found that West Penn demonstrated that its 25% reserve margin decision was supported by studies available when the decision was made and by informed judgment based on experience, and recommended approval of the 25% planning reserve margin.

OCA and Armco/Allegheny excepted to the recommendation. OCA reiterates its claim that Allegheny Power Systems ("APS"), West Penn's parent company, should have conducted new reserve margin and generation planning studies in 1986, which would have indicated that the planning reserve margin should have been no more than 20% based primarily on an increase in unit availability on the APS system between 1983 and 1986 and OCA's view that large interconnected systems generally have a reserve margin of 15% to 20%. Armco/Allegheny reiterate their claim that West Penn did not meet its burden of proof with respect to its 25% planning reserve margin because the studies relied upon by West Penn were outdated and because West Penn and APS have allowed their reserve margins to drop below 25% by entering into agreements for the sale of 700 MW to out-of-state utilities.

West Penn's Reply Exceptions state that the issue is not, as OCA and Armco/Allegheny would like frame it, whether APS should have done a formal study in 1986 but whether, in light of the objective information avail-

able to APS planners in 1986, the judgment to use a 25% planning reserve margin in calculating avoided costs for these contracts was reasonable. West Penn states that the ALJ correctly concluded that its judgment regarding the proper planning reserve margin was appropriate given, *inter alia,* the existence of the super-critical units on the APS system, APS' high load factor, and the availability of the units. With respect to Armco/Allegheny's exception, West Penn states that the 700 MW off-system sale in the winter of 1988/89 has no bearing on APS' planning reserve margin because the sale is interruptible and subordinate to native system load, which permits APS to use its existing capacity effectively without compromising system reliability. APS does not plan for off-system sales when determining that new capacity is needed; therefore the projected addition of capacity in 1995 was planned to meet native load plus a 25% reserve margin, as opposed to native load, plus off-system sales, plus 25%. West Penn notes that the 700 MW off-system sale actually was a sale of 700 MW for one year dropping to 300 MW for six years and zero thereafter.

The Projects' Reply Exceptions emphasize that West Penn's 25% planning reserve margin had been sanctioned by the Commission in two prior proceedings, that the reserve margin is being used for planning purposes by West Penn to this day, and that West Penn still projects a need for energy in 1995. The Projects state that the reasonableness of West Penn's planning reserve margin is the issue, not the exact results of West Penn's forecasts.

Upon review of the Exceptions and Reply Exceptions we find nothing that was not considered by the ALJ prior to making his recommendation that West Penn's planning reserve margin of 25% be adopted. The ALJ's decision on this issue is persuasive and we adopt it as our own. We find particularly persuasive the rebuttal testimony of West Penn's Director of Planning regarding the factors

that were taken into account in establishing the reserve criterion, particularly the existence of ten super-critical units ranging in size from 540 mw to 640 mw, each of which is about 10% of the APS system peak load; APS' high load factor, which is normally one of the ten highest load factors of the top 100 investor-owned utilities in the country; and the uncertainty whether the recent improvement in unit availability would continue given, *inter alia*, the fact that the equipment is aging and the temporary lower stress levels on individual units resulting from temporarily higher operating reserves. One issue raised on exception that was not addressed by the R.D. was Armco/Allegheny's argument that the *interruptible* off-system sale of 700 MW in 1988/89 (dropping to 300 MW for six years) demonstrated that West Penn did not need additional capacity. We find this completely unpersuasive for the reasons set forth in West Penn's Reply Exceptions.

c. *Coal Unit v. Combustion Turbine, R.D. at 71-80.*

The capacity credits in this proceeding were based on West Penn's projection in 1986 that the next generating unit it would construct would be a series of three 300 MW coal units, the first of which would be brought on line in 1995. OCA argued that in 1986 West Penn should have planned to construct oil or gas fired combustion turbines ("CTs") to provide peaking capacity before constructing additional coal units. The ALJ concluded that West Penn submitted substantial evidence to support the APS decision in 1986 that a coal unit would be required in 1995.

OCA excepted to this finding, arguing that peaking units (oil or gas fired CTs) should have been planned by West Penn rather than base load generation in the form of coal fired units. OCA's preference for oil or gas fired units is based on arguments pertaining to need for fuel

diversity, projected fuel costs for the coal plant v. marginal fuel costs on the system, and the use of a dependent forced outage rather than actual unit unavailability in West Penn's studies.

West Penn's Reply Exceptions state that the APS 1986 Generation Plan was supported by considered judgment based on the following factors:

(1) the many years of satisfactory service provided by coal-fired units to APS and its ratepayers;

(2) the drastic escalation in the price of oil and gas even though tempered by a drop in prices in late 1985 and early 1986;

(3) the results of studies that at best showed only a minor financial advantage for combustion turbines;

(4) the technological limitation(s) on combustion turbines at that time; and

(5) public policies and laws designed to encourage the use of coal.

West Penn's Reply Exceptions refer to its Main Brief and Reply Brief, which refute the arguments in support of an oil or gas fired peaking unit raised by OCA. With respect to fuel diversity, West Penn states that the objective is not to provide a pre-determined fuel mix, but to provide a reliable power supply at the lowest cost, which should be done by using the fuel sources that are the most reliable and cost the least over the planning horizon. West Penn notes that the APS service area has large reserves of coal that have over time provided a stable supply of fuel at a reasonable cost; that the availability and price of oil and gas have been unpredictable and uncertain; and that the economy of the APS service area benefits from the use of coal.

With respect to OCA's argument comparing fuel costs of a coal plant to the fuel costs of the APS system, West

Penn states that even if the new coal units were projected to have a higher operating cost than the average costs on the system, it is inappropriate to compare operating costs between types of generation. West Penn notes that if this type of comparison were to be made, CTs always would have exceedingly high costs (about 4¢ to 10¢/kwh depending on oil and gas prices) compared to coal. West Penn states that neither of the computer runs discussed by OCA shows either a large benefit or cost to installing CTs, and that there certainly was not enough difference to make a decision based *only* on computer runs. West Penn avers that "[t]he decision to stay with coal fired generation was based on the experience of many years and common sense. *The use of coal has been the reason the APS cost of electricity has been among the lowest in the country.*" West Penn Reply Brief at 12 (emphasis supplied).

With respect to OCA's argument on the use of dependent forced outage rates, West Penn states that the purpose of using these rates is to better model the way the power system actually operates. While most computer models use an average forced outage rate, in actual practice many units may be out of service at one time, necessitating the use of CTs. West Penn states that if there are many units out of service at the same time, usually it is due to some type of dependency, i.e., weather-related, equipment similarities, storms, etc. When these dependent forced outage conditions do occur, necessitating the use of CTs, it might be necessary to run them eight to thirteen hours a day because of the APS high daily load factors, where hourly loads do not vary much over long periods during the day.

The Projects' Reply Exceptions state that OCA's entire argument that the avoided unit should have been a CT rather than a coal-fired unit is that planning and judgment cannot be used along with a least cost study. The Projects state that, while all of West Penn's planning

for the mid-1990's included adding base load plant in 1995, OCA unilaterally decided that West Penn should add peaking power in that year and assumed a low cost and available source of oil in 1995 and beyond. The Projects state that none of OCA's assumptions as to oil prices were known in early 1986, and that OCA's continued reliance on its argument with respect to cheap and stable oil prices in the future is unsupportable in light of the current state of the fuel market. Finally, the Projects note that West Penn added considerable peaking capacity in 1986 (the Bath County Pumped Storage Unit), and that there is nothing on the record to support the proposition that another large peaking unit is needed next.

We agree with the ALJ's recommendation on this issue; further we find compelling reasons supporting West Penn's choice of a coal-fired base load unit as opposed to an oil or gas-fired CT as the next generating plant on the system. Even assuming for the purposes of argument that studies showed a financial advantage to CTs, the advantage was minor at best. West Penn appropriately used its experience and judgment as well as formal studies when formulating its capacity addition plans. Its experience supported the choice of a coal unit for many reasons, including the many years of satisfactory service of coal units to its ratepayers, and the fact that the reason West Penn's rates are the lowest in Pennsylvania and among the lowest in the country is due to the use of coal. The volatility in the supply and price of natural gas and oil as well as the public policy in Pennsylvania of encouraging the use of coal also supported its decision. Additionally, West Penn's high daily load factor supports the decision to add additional base load capacity, as opposed to oil or gas fired peaking units (with low capital costs but high fuel costs), as well as the use of dependent forced outage rates in its studies. In sum, we strongly endorse West Penn's decision to add a coal-fired unit as opposed to an oil or gas-fired CT as its next generating unit. Selection of a CT over a coal unit due to at best a

minor financial advantage produced by a formal study in our opinion would have been unwise. First, it would have exposed ratepayers to the volatility in the supply and price of oil and gas in the future; whereas coal supplies in the APS service territory are abundant and can be procured under long term contract. Second, in our opinion West Penn gave appropriate consideration to the public policy in Pennsylvania of encouraging the use of our indigenous coal resources and the economic benefits in the service territory resulting from the use of coal. The choice of a coal unit over a CT has more than theoretical consequences for the Projects under consideration, even though the Projects are designed to avoid or defer the construction of the next unit by APS. The Projects are themselves capital-intensive as they are designed to utilize coal and coal waste. Generally speaking, a capital-intensive project cannot be supported by capacity credits derived from a low cost combustion turbine. Moreover, we note that OCA did not advocate revising the Projects' *energy* credits (which were not challenged by any party to these proceedings) to reflect the fact that its avoided unit of choice would be fired by oil or gas as opposed to coal. It is an interesting position that advocates capacity rates based on a cheap oil- or gas-fired combustion turbine and energy credits based on coal.

There is an independent reason why basing the capacity credits in this proceeding on a coal plant was required that was not addressed by the ALJ's R.D. As West Penn notes in its Reply Brief, in 1986 it was anticipating inadequate system reliability within the next ten years as a result of not being committed to sufficient plant because its reliability criterion of a 25% reserve margin would not be met without additional generating units. Under 52 Pa. Code § 57.34(c)(4)(iii) this triggers the required use of a coal plant as a proxy. Therefore, in addition to the fact that West Penn reasonably selected a coal plant as its next generating unit, our regulations would have required the payment by West Penn

of capacity credits based on a coal plant even if West Penn had not selected any particular type of generating unit at all.

For all of the foregoing reasons, we find that the capacity credits in this proceeding should be based on the costs of a coal-fired generating unit.

d. *Mitchell and Springdale Units, R.D. at 81-85.*

In 1983 West Penn's Springdale and Mitchell generating units were placed in cold reserve and removed from West Penn's rate base. In the Bath County litigation it was determined that the Springdale and Mitchell units, collectively 361 MW, would not be considered installed capacity for the purpose of evaluating whether the Bath County pumped storage project was excess capacity. WPPII argued that West Penn could return the units to active service by expending $71 million, and that West Penn's capacity credits should have been based on the reactivation costs rather than a new 300 MW coal unit. West Penn responded by noting that its 1986 Generating Capacity Plan showed the need for additional capacity in 1995 *despite* the planned reactivation of Springdale and Mitchell in 1992 and 1993. West Penn also noted that Mitchell and Springdale are oil-fired peaking units, and the Commission's regulations base capacity credits on a peaking unit only when it is due on-line within five years. Since in 1986 Springdale and Mitchell were not "committed" units under the regulations, they were properly not used as the basis of the capacity credits in West Penn's avoided costs calculations.

The ALJ agreed with West Penn's application of the facts to the Commission's regulations at 52 Pa. Code § 57.34(c)(4)(i) and (iii), while disagreeing with West Penn's conclusion that the regulations require the use of costs associated with a new plant, as opposed to one in cold reserve. The ALJ rejected Armco/Allegheny's argument that the capacity credits in these proceedings should

be based on the costs of reactivating Springdale and Mitchell.

No exceptions to the ALJ's recommendation on this issue were filed. We agree with the ALJ and find that the costs of reactivating Springdale and Mitchell were not the proper basis for determining West Penn's avoided costs in these proceedings. West Penn's Generating Capacity Plans in 1986 showed West Penn's need for a 300 MW coal unit in 1995 *in addition to* the planned reactivation of Springdale and Mitchell in 1992 and 1993.

Where a utility projects a need for more than one capacity addition, nothing in our regulations bars the payment of capacity credits based on more than one plant. Therefore, although it was appropriate for West Penn to offer the projects in these proceedings capacity credits based on its 1995 coal plant, West Penn also could have offered capacity credits to other QFs based on the reactivation of Springdale/Mitchell in 1987-1988 (five years before the planned reactivation). Although the resulting capacity credit would have been extremely small, the energy credit associated with Springdale and Mitchell, which are oil-fired, would have been substantially higher than the energy credits at issue in these proceedings. In sum, just as utility capacity addition plans are not mutually exclusive, capacity credits based on different capacity addition plans likewise are not mutually exclusive. In 1986 the appropriate plant upon which West Penn's avoided costs were based was the 1995 coal plant; even if West Penn had planned to reactivate Springdale and Mitchell within five years or by 1991, the Projects in question would have had the choice of which capacity addition plan they would help defer or avoid, which would in turn determine their appropriate avoided costs.

e. *Fixed Charge Rate, R.D. at 85-95.*

West Penn utilizes a levelized annual fixed charge rate ("FCR") to estimate the cost of owning capital assets. The principal elements of the FCR are the cost of capi-

tal, depreciation, income taxes, insurance, and property related taxes. West Penn used a FCR of 17.7% for all three contested Projects. Armco/Allegheny argued for a FCR of 13.88% for Milesburg and 14.65% for Burgettstown and Shannopin. The ALJ concluded that West Penn calculated its FCR correctly and recommended its acceptance.

No exceptions were filed with respect to the ALJ's findings on cost of capital, capital structure, cost of debt, cost of preferred stock, state and federal taxes, ad valorem rate (insurance and property taxes), or rate base. We adopt the ALJ's recommendation on these issues as our own.

Armco/Allegheny excepted to the ALJ's recommendation to adopt West Penn's forecasted return on equity of 15%. West Penn's forecast was made by adding a risk premium of 400 basis points to forecasted bond rates, since it is universally recognized that investments in common stock are riskier than investments in bonds. To encourage investment in common stock, it is necessary to provide a higher return than an investor could receive in the bond market.

Armco/Allegheny argue that the most appropriate return on equity would be the return of 14.25% approved by the Commission in July 1986 in West Penn's Bath County rate proceeding at Docket No. R-850220. Armco/Allegheny argue that only the Commission can set a utility's return on equity, and that West Penn, unlawfully usurped the Commission's authority by forecasting a higher rate of return. Armco/Allegheny state that West Penn committed its ratepayers to pay a higher return on equity to the QF developers than the Commission had required West Penn's ratepayers to pay to the utility.

West Penn's Reply Exceptions note that the return on equity in the FCR for these avoided cost calculations required economic forecasting for the life of the contracts, *i.e.*, as far out as the year 2031 (33 years past 1998). Armco/Allegheny did not contest the reasonableness of

West Penn's projections; rather, Armco/Allegheny contended that using *any* projection was an error of law. West Penn states that Armco/Allegheny's argument defies logic and erroneously assumes that West Penn's return on equity is static and will remain at 14.25% for over 33 years. The Projects' Reply Exceptions note that Armco/Allegheny did not argue that West Penn's forecast was incorrect, and that the rates for each of these Projects were first quoted to developers prior to July 24, 1986, when the return on common equity from the then prior rate case was 15.5%.

Armco/Allegheny's argument on this point requires little discussion. We agree with West Penn that it defies logic to assume that West Penn's rate of return on equity will remain static for the next 30-40 plus years. All components of an avoided cost calculation, including a fixed charge rate, require the use of reasonable projections. The use of a forecasted 15% return on equity did not usurp a Commission function. Therefore, we adopt the ALJ's recommendation on this issue.

f. *Availability Factor.*

Armco/Allegheny have excepted to the fact that, through an oversight, the ALJ's R.D. failed to rule on their argument that the availability factor of the avoided coal unit should have been 80% rather than 75%. The availability factor is the percentage of time during the year that the avoided unit would be expected to operate, and is used as a component in the calculation of West Penn's capacity credit. The lower the assumed availability factor, the higher the capacity credit because the cost of the avoided unit will be spread over fewer Kwh. Armco/Allegheny aver that the newest scrubbed coal-fired units on the APS system are the 621 MW Pleasants Units, which had average availabilities of 80-81% between 1983-1987. Armco/Allegheny aver that, although the only other scrubbed coal-fired unit on the APS system, Mitchell No. 3, had an availability of only 73.9% between 1983-1987, it is more appropriate to use the Pleasants Units

because they are newer and provide a better indication of the expected availability of units that would be built in the mid-1990s.

West Penn's Reply Exceptions state that Armco/Allegheny selectively analyzed APS availability data in order to find an example to support its contention. West Penn takes into account many factors, including potential acid rain legislation, in forecasting future availability. Selections of one four year average availability of one unit does not support an assumption that West Penn should anticipate that particular availability over the economic life of the avoided unit. The Projects' Reply Exceptions similarly state that the selection of only *one* time period for *one* unit does not support use of the corresponding availability factor.

On this issue we agree with West Penn, and reject the argument of Armco/Allegheny. Selection of one four year period for one unit does not support an assumption that the avoided unit would have had an equivalent availability factor over its useful life. Even if the Pleasants Units were selected as the best representative *units* on the APS system, the four year *period* of 1983-1987 selected by Armco/Alleheny occurred very soon after Pleasants Units 1 and 2 were placed in-service in 1979-1980. It is unreasonable to assume that a plant will continue to operate over its 30-33 year life at the same availability factor that it did when it was nearly new. Over time, equipment ages and must be replaced. Therefore, we find that the four year availability factor cited by Armco/Allegheny is not particularly relevant, and adopt West Penn's projection of a 75% availability factor for the life of the avoided unit.

5. *Section 527 of the Code, R.D. at 95-97.*

The ALJ's R.D. rejected Armco/Allegheny's argument that Section 527 of the Public Utility Code, 66 Pa.C.S. § 527, requires discounts from full avoided costs. We

rejected this argument previously in our Order on Reconsideration in these proceedings entered January 19, 1989. Nevertheless, Armco/Allegheny argue that Section 527 applies to negotiated rates as opposed to rates set administratively by the Commisison.

The ALJ rejected Armco/Allegheny's argument as "engaging in legislative mindreading with no support except stretched logic." R.D. at 97. The ALJ concluded that, since Section 527 cannot be used against full avoided cost rates calculated under the Commission's regulations, neither can it be applied to full avoided cost rates in a voluntary agreement. The ALJ notes that, even though not mandated by Section 527, the record in these proceedings demonstrates that the EEPA rates are below West Penn's avoided costs.

Armco/Allegheny's Exceptions at p. 32 repeat their assertion that "Section 527 clearly requires that in Pennsylvania rates paid to QFs should be *less than* avoided costs since this is the only way to provide ratepayers with savings as a result of cogeneration." (emphasis supplied). While conceding that the federal full avoided cost standard applies to rates imposed by the Commission as a result of a complaint proceeding, Armco/Allegheny assert that PURPA does not apply to a negotiated contract. Armco/Allegheny also argue that none of the contracts under consideration provide for savings since West Penn's input assumptions into its methodology were erroneous, and that even if the inputs were correct, the savings under the contracts are not enough.

West Penn's Reply Exceptions state that Section 527 is clear on its face and, rather than mandating discounts from avoided costs, requires only that discounts that do exist be passed on to ratepayers. West Penn states that there is no legislative history to support Armco/Allegheny's interpretation of Section 527, and that any requirement that rates available to QFs in voluntary contracts be below avoided costs would be preempted by federal law.

The Projects' Reply Exceptions characterize Armco/Allegheny's argument on this issue as farfetched, and note that the Federal Energy Regulatory Commission ("FERC") directly addressed the savings issue and mandated that rates to QFs be set at a utility's *full* avoided costs. The Projects echo West Penn's interpretation of Section 527 as requiring utilities to pass any savings that exist to customers rather than retaining a profit on purchases of power from QFs.

On this issue we agree with the ALJ's R.D. Armco/Allegheny's argument is based on stretched logic and, if accepted, would result in an interpretation of Section 527 that would violate federal law. When promulgating its rules under PURPA 210, FERC considered and rejected arguments that rates to QFs should produce savings to customers. FERC mandated that rates for purchases be set at a utility's *full* avoided costs. *Small Power Production and Cogeneration Facilities; Regulation Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978*, Docket No. RM79-55, Order No. 69 (February 19, 1980), 45 *Fed. Reg.* 12214, 12222 (February 25, 1980). The full avoided cost standard was reviewed and approved by the U.S. Supreme Court in *American Paper Institute v. American Electric Power Service Corp.*, 461 U.S. 402 (1983). Therefore, unless and until the full avoided cost standard is revised by FERC, any interpretation of Section 527 as requiring discounts from full avoided costs would be unconstitutional. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). Armco/Allegheny's argument that negotiated rates are not governed by PURPA is equally invalid. Although FERC's and this Commission's regulations allow a QF to voluntarily accept rates below a utility's avoided costs, there is nothing to support an argument that a utility cannot voluntarily agree to pay full avoided cost-based rates. If this were so, a utility could not voluntarily comply with PURPA 210! Rather, utility compliance with PURPA could be achieved only upon the filing of a formal complaint. This is clearly

unsupported and we reject Armco/Allegheny's argument in its entirety.

6. *OCA's Correction to Milesburg's EEPA, R.D. at 97-100.*

This issue was addressed in Phase I of the ALJ's R.D. We will address it in Phase II. Our intention is that Phase I issues addressed in our Order be applicable to all four proceedings. Issues that are specific to an individual Project will be discussed in Phase II, and our Order(s) in Phase II will be specific as to each individual docket number.

7. *Capacity Costs Allocated on a Demand/Energy Basis, R.D. at 101-105.*

This rate structure issue involves the methodology by which QF capacity payments will be recovered from ratepayers. Currently, all QF costs (energy and capacity) are recovered through West Penn's Energy Cost Rate mechanism ("ECR"). West Penn currently has approximately 135 MW of QF capacity on-line. The Projects in these proceedings represent another 205 MW. While rates paid to Monongahela, Milesburg, Burgettstown and Shannopin will not be reflected in customers' bills until the Projects are financed and constructed, West Penn's existing ECR recovers all costs paid to QFs on an energy or kwh basis. WPPII and Armco/Allegheny advocate recovery of QF capacity payments from ratepayers on a demand/energy basis through the ECR in a manner similar to that which would have occurred if the capacity had been built by West Penn and the costs allocated on cost-of-service principles in base rates. Armco/Allegheny advocated the adoption of a particular mechanism to achieve a demand/energy allocation based on a single coincident peak methodology.

The OCA opposed Armco/Allegheny's proposal on the basis that (1) it would add complexity to West Penn's

ECR; (2) the single coincident peak methodology was not utilized for Bath County; (3) a single coincident peak methodology could result in volatile changes in cost allocations depending on peak responsibility for a single day; and (4) the rate structure issue has not been set for decision by the Commission in these proceedings.

The ALJ concluded that both Armco/Allegheny and OCA were correct. Finding that the reasons for using a demand/energy allocation are sound, but that the allocation should not be set in this proceeding, the ALJ recommended that West Penn be directed to make a demand/energy allocation in its next ECR filing, and that all existing on-line QF capacity be included. OCA excepted, reiterating its position that no action on the rate structure issue should be taken in these proceedings. OCA states that the Commission has never held that it is necessary to determine QF rate structure years in advance of the time when the costs will be collected from customers. OCA also states that no notice was provided to ratepayers that rate structure issues would be determined in these proceedings. North Branch also excepts, stating that West Penn's Petition for Approval of the North Branch EEPA did not request approval to pass the costs through to ratepayers pursuant to any particular allocation method, and that the allocation issue should be decided in a separate proceeding.

WPPII's Reply Exceptions state that the Commission has expressed an unwillingness to review the demand/energy allocation of QF purchased power costs in the context of an ECR proceeding, and that the ALJ recommended only that the *principal* of a demand/energy allocation be adopted in this proceeding, leaving the particular methodology to a later proceeding where all parties will be afforded an opportunity to be heard. WPPII notes that West Penn currently is collecting QF purchased power costs through its ECR. WPPII argues that the rate structure issue is relevant to these proceedings be-

cause rate recognition permits West Penn to recover costs through its ECR mechanism. WPPII states that ratepayer indifference embodied in PURPA should be preserved. Finally, WPPII states that modifying the practice of allocating QF capacity costs on a kwh basis will alleviate any need for industrial intervention in QF development.

Armco/Allegheny's Reply Exceptions state that the demand allocation issue is within the scope of these proceedings because: (1) failure to allocate capacity costs on a demand basis would violate the underlying premise of PURPA of customer indifference; (2) West Penn's rate recovery petitions sought ECR pass through; and (3) the ALJ did not recommend that any particular type of allocation be adopted in these proceedings.

We agree in part with the ALJ's recommendation and adopt the R.D. on this issue up to the conclusion of the first paragraph on p. 104. However, the ALJ's statement that the costs in question will not be recovered until West Penn's next ECR proceeding is inaccurate. The capacity costs at issue in these proceedings will not be recovered for several years as the Projects proceed to financing construction. Therefore, there is no overriding necessity to revise West Penn's ECR in its next ECR filing.

This rate structure issue is one that will take on added importance in the future as utilities begin to substitute purchases from QFs for their own construction. If QFs begin to represent a more significant portion of a utility's installed capacity, continued recovery of capacity charges on an energy basis through a fuel clause mechanism would incorporate a bias against high load factor customers (usually energy intensive industrial customers). While we have strongly supported the continued development of cogeneration and small power production as in ratepayers' best long-term interests, a rate structure bias against a particular customer class certainly would not be our intent. In order to fully analyze the complexities

inherent in a modification to West Penn's ECR so as to achieve ratepayer indifference, we will require a report and recommendation from our Bureau of Audits, with the assistance of the Law Bureau, on how best to proceed. Upon receipt of this report we will determine whether opening a formal investigation into West Penn's ECR or some other action is required. As stated above, the capacity costs currently being recovered through West Penn's ECR are not substantial, and there is no overriding need to implement an ECR modification in West Penn's next ECR filing. Our preference is to proceed on this issue at a slower pace to ensure that the final result will accomplish our objectives. Therefore, we will request the Audits/Law Bureau report within three months of the date of this Order and will endeavor to initiate formal action shortly thereafter.

8. *Excess Capacity, R.D. at 105-107.*

The ALJ recommended a finding that the addition of the QF capacity under consideration does not result in excess capacity under Section 1323 of the Public Utility Code, 66 Pa.C.S. § 1323, with respect to the capacity itself or as to any existing West Penn capacity.

The OCA's Exceptions request clarification of the scope of the excess capacity determination. Specifically OCA requests a finding that the QF capacity in these proceedings *must* be considered in determining whether *future* West Penn plant additions represent excess capacity. No Reply Exceptions were filed.

We affirm the ALJ's decision on this issue. Section 5.3(i) of each of the EEPAs at issue requires, as a condition precedent to West Penn's obligations thereunder, that the Commission either adopt policy guidelines or enter an order to the effect that the QF capacity in question will not be treated as "excess capacity" under Section 1323 either as to the projects themselves or as to any existing West Penn capacity, including the Bath

County project. That determination has been made. We see no need to clarify the determination as OCA has suggested. To do so would constitute ruling on the merits of a case that is not before us and clearly would be improper. However, we note in general terms that it has never been our intention to exclude consideration of existing QF capacity from excess capacity determinations for future utility plant. A more specific statement is not appropriate at this time.

9. *Conclusion.*

Phase I of our Order addresses issues that are applicable to each Project and is hereby adopted with respect to all four proceedings and docket numbers under consideration. Resolution of Phase I issues concludes our Order with respect to the Monongahela and Shannopin EEPA. On the basis of Phase I of our Order, the capacity credits of 3.6¢/kwh and 4.0¢/kwh for Monongahela and Shannopin, respectively, are approved. Orders specific to these two proceedings are appended to this order. Phase II issues remaining for consideration are specific to the Milesburg and Burgettstown Projects. Phase II of our Order in turn will be separated between Docket Nos. P-870216 (Milesburg) and P-880284 (Burgettstown).

B. PHASE II—BURGETTSTOWN

Docket No. P-880284.

North Branch filed a Petition for Modification of its EEPA on April 5, 1989 requesting modification of milestone dates and an increase to its capacity rate to reflect the delay in its in-service date occasioned by the lengthy approval process to which it has been subjected. The capacity credit for Burgettstown was based on the Project being placed in service on October 1, 1991. Among other related milestones, under its EEPA Burgettstown must hold a full financial closing before October 1, 1989 or its EEPA will by its own terms expire. Although West Penn

filed the Burgettstown EEPA with the Commission for approval in January 1988, unforseen circumstances have delayed approval for nearly two years. Without Commission approval of the EEPA in the form of a final and *nonappealable* Commission Order, financing and construction cannot take place. As a result, it is impossible for Burgettstown to meet its contractual milestones. North Branch presented unrebutted testimony that financial closing would take six (6) months from the date of a final and nonappealable order, and that construction would take approximately thirty-three (33) additional months, for a total of thirty-nine (39) months.

The ALJ recommended that North Branch's Petition for Modification be denied. North Branch excepts to the ALJ's failure to recommend modification of the milestones in its EEPA. North Branch also excepted to the failure of the ALJ to recommend an increase to its capacity credit of 3.6¢/Kwh. However, on September 8, 1989 North Branch filed an Amendment to its Exceptions, thereby withdrawing its request for an increase to its capacity credit. Therefore, the only issue before us is whether or not North Branch's request for an extension to its financing and related milestones should be granted.

North Branch states that the ALJ's recommendation not to modify the various milestone dates is illogical because litigation before the Commission has prevented North Branch from meeting the milestones. Although the ALJ recommended that North Branch's EEPA be approved, approval of the EEPA without the requested modification effectively cancels the EEPA and rewards the intervenors for having presented a meritless case. With respect to the ALJ's characterization of North Branch's request for an extension as open-ended, North Branch states it requested six (6) months from a final order for the Financing Closing Date, which is not open-ended. Given the fact that the plant does not have to be in-service until October 1, 1995 to meet West Penn's

needs, the Financing Closing Date could occur as late as January 1, 1993 without presenting a risk to West Penn's planning process. North Branch states that the Commission should consider the environmental and economic benefits of the Burgettstown Project, the substantial savings to ratepayers from the Project, the inequity of not granting the extensions, the great effort and expense incurred by the developers, and the reasonableness of the modifications requested when reviewing North Branch's Exception.

West Penn's Reply Exceptions state that the extensions entail risk to ratepayers that West Penn will not have sufficient time to replace the capacity at a reasonable cost if the Project fails to go in-service at a time when the need is critical. West Penn asserts that projects of this magnitude require years of lead time before construction commences. West Penn states that the developer has the ability to limit its exposure and walk away from the Project at any time, while West Penn does not have the same luxury with respect to its obligation to serve its customers. West Penn states that the ALJ properly questioned whether forced extensions of milestone dates in fully negotiated contracts for an unpredictable period of time should take precedence over a utility's obligation to serve.

Armco/Allegheny's Reply Exceptions argue that the Commission cannot turn a negotiated PURPA contract into a non-negotiated PURPA contract if the resulting contract is not in compliance with federal and state regulations. Armco/Allegheny state that, if Burgettstown is no longer satisfied with its EEPA, it is free to seek a non-negotiated agreement in compliance with the state and federal regulations through the initiation of a new proceeding at the Commission.

We will reverse the ALJ's recommendation on this issue. The Burgettstown Project has been before us for approval since January 1988. Due to unforseen events,

primarily the issuance of the Commonwealth Court decision in *Barasch v. Pennsylvania Public Utility Commission,* 119 Pa. Commonwealth Ct. 81, 546 A.2d 1296 (1988) (*"Milesburg"*) and the resulting necessity to initiate a bill insert notification procedure and evidentiary hearings thereafter, resolution of this proceeding has been delayed substantially. In essence, a proceeding that began as a request for a declaratory order evolved in a vigorously contested rate proceeding that took over twice as long to complete as a major general rate increase proceeding under 66 Pa. C.S. § 1308(d). At today's conclusion of the proceeding, we have affirmed the ALJ's recommendation and found that the Burgettstown EEPA should be approved as providing for rates that are at or below West Penn's avoided costs. If we were to deny North Branch's request for modification to its milestone dates, its EEPA with West Penn would expire by its own terms on October 1, 1989. This result would be untenable, akin perhaps to a doctor meticulously evaluating diagnostic procedures for a patient that died for want of treatment.

In our view it is essential that regulatory delay in the proceeding be recognized and reflected in our Order. To do otherwise would merely extend an open invitation to interventions in opposition to future QF proceedings since intervenors would realize that they could win by default, through the passage of time alone, results that could not be won on the merits. Although we are cognizant of West Penn's concerns regarding orderly capacity planning, our failure to grant North Branch the requested extension would leave an 80 MW shortfall in West Penn's generation plans. If West Penn attempted to make up for the shortfall by beginning the contract negotiation process anew with another developer, we would question the fate of that contract as well in the face of probable opposition and a Commission policy against reflecting and accounting for regulatory delay. To date North Branch has completed substantial development work and

the lengthy review process by the Commission finally has been completed. North Branch is ready to proceed to financing, barring any appeals of our Order. Therefore, to in essence "pull the plug" on the Burgettstown Project at this late stage would inject the very uncertainty in West Penn's generation plans that it seeks to avoid. Similarly, it is no answer to, as Armco/Allegheny suggest, require North Branch to begin anew with a new evidentiary proceeding to obtain a contract with West Penn at rates established under the Commission's regulations. The point of requiring North Branch to begin from square one with a complaint proceeding requesting rates higher than the ones it has accepted is lost to us, unless of course the point is to defeat this Project through a war of attrition.

We therefore will grant North Branch's petition for modification and extend the Financing Closing Date to six months after the issuance of a final nonappealable Commission Order in this proceeding, with corresponding adjustments to related contractual milestones. We also will grant North Branch's August 21, 1989 Application for Stay of the Financing Closing Date in recognition of the fact that, under Section 508, 66 Pa. C.S. § 508, an Order modifying a contractual provision does not take effect until thirty (30) days after it is entered. Therefore, the effect of Section 10.2(c) of the EEPA will be stayed pending the effective date of the portion of our Order granting the contractual modifications.

C. PHASE II—MILESBURG

Docket No. P-870216.

As stated above, Milesburg's contract has been before the Commission and/or the Commonwealth Court since April 2, 1987. The issuance of the Commonwealth Court's decision in *Milesburg* in August 1988 necessitated the preparation and mailing of a bill insert notice and the holding of hearings before an ALJ. The ALJ

has recommended, and we have adopted, an Order affirming the reasonableness of the input assumptions utilized by West Penn's in the calculation of its avoided costs.

The capacity credit of 3.3¢/Kwh in the EEPA was based on an in-service date in 1990. Milesburg's original Financing Closing Date of September 1, 1988 was extended to February 28, 1989 by a Consent Order entered into by all parties and approved by the Commission on September 1, 1988. On February 9, 1989 Milesburg filed a petition to, *inter alia,* further extend its Financing Closing Date. Although the ALJ issued an order on February 21, 1989 granting the petition, he rescinded it on February 27, 1989 in recognition of the fact that it was issued without a hearing as required by Section 508 of the Public Utility Code, 66 Pa. C.S. § 508. N.T. at 7. On March 3, 1989 Milesburg filed a Petition for the Issuance of an Interim Emergency Order or Appeal of Judge Gesoff's February 27, 1989 Order. Milesburg requested that the Commission issue an emergency order granting relief from the Financing Closing Date of February 28, 1989 or, in the alternative, reinstate the portion of the ALJ's February 21, 1989 Order that extended the Financing Closing Date while remanding the issue to the ALJ for a hearing on the merits. West Penn and Armco/Allegheny filed responsive pleadings in opposition to Milesburg's March 3, 1989 emergency petition. By Order entered March 31, 1989 the Commission denied Milesburg's request for an Emergency Order but granted limited interlocutory review of the ALJ's February 27, 1989 Order and required all parties to maintain the status quo with respect to the EEPA pending consideration by the ALJ, and ultimately the Commission, on Milesburg's February 9, 1989 petition for modification. Our Order parenthetically noted that:

> [I]t may be in the interests of West Penn and its ratepayers to retain [Milesburg] under a voluntary agreement setting forth a negotiated rate for the sale

of power. Absent a negotiated rate, [Milesburg] is entitled to a capacity (and associated energy) rate determined in accordance with our regulations. A key issue of first impression would be the time frame to be utilized in determining [Milesburg's] avoided cost-based rate. Although we express no opinion on this issue at this time, our preliminary observation is that [Milesburg's] situation may be distinctly different from the situation considerd by us in *Petition of Pagnotti Enterprises,* Docket No. P-870281 (August 19, 1988). In *Pagnotti,* a negotiated purchased power rate had been approved by the Commission on June 30, 1986, and our June 30, 1986 Order became final and nonappealable on July 30, 1986. The project participants in that proceeding failed to meet, in large part, an agreed-upon financing deadline of December 31, 1986, which occurred approximately five (5) months after the issuance of the final, nonappealable order that is necessary for a project's financing. We found in *Pagnotti* that, by missing the financing deadline, the project participants had waived their entitlement to rates based on Pennsylvania Power & Light Company's ("PP&L's") avoided cost projections as of the time that serious negotiations took place, and that the project therefore was entitled to rates based on PP&L's avoided costs projections as of January 1, 1987. In the instant proceeding, [Milesburg] has never been the beneficiary of a final, nonappealable Commission Order approving rate recovery of amounts proposed to be paid by West Penn. In fact, [Milesburg's] agreement with West Penn has been before the Commission and/or the Commonwealth Court for nearly two years. Without a final nonappealable Commission Order, a project such as [Milesburg's] cannot receive financing. Therefore, it may be that, if asked to rule upon this issue of first impression in Pennsylvania, we may determine that

> [Milesburg] has not waived its entitlement to rates based on West Penn's avoided costs as of the time that serious negotiations between West Penn and [Milesburg] took place;

Order at 8-9.

The ALJ recommended that Milesburg's requests to extend its milestone dates and to revise its capacity credit to reflect its delayed in-service date be denied. In the event that the Commission reversed this recommendation, the ALJ recommended that Milesburg's capacity credit be recalculated by incorporating a change in West Penn's methodology to reflect monthly, as opposed to annual, payments.

Milesburg excepted, stating that it has been clearly demonstrated that the requested modified rates are at or below West Penn's avoided costs and substantially below the rates to which Milesburg is entitled under the regulations, and that the Project will bring considerable economic and environmental benefits to Pennsylvania. Milesburg states that the requested modified capacity rates are merely the rates that would have been available to it had the delayed in-service date been anticipated. Milesburg asserts that the ALJ's suggestion that Milesburg initiate another proceeding to seek rates under the regulations is illogical because it would cost the ratepayers more for power. Milesburg argues that there never was any intent that the Commission intended to forego review of Milesburg's request, notwithstanding the fact that its EEPA lapsed on February 28, 1989. Milesburg points to language in the September 1, 1988 Consent Order as indicative of an agreement among the parties that the Commission would consider an extension beyond February 28, 1989. Milesburg further points to the Commission's Order of March 31, 1989 as indicative of the Commission's intent that the petition for modification be considered on the merits. Milesburg avers that if the ALJ had correctly recognized the Commission's intent

and authority to modify the EEPA, the ALJ would have found the modifications to be in the public interest. Milesburg takes specific exception to the conclusion of the ALJ that there is no evidence on the record upon which to conclude that West Penn is hostile to the Projects, since West Penn refused on two occasions to negoiate modifications to the EEPA, and to the conclusion that West Penn would not have sufficient time to replace the Milesburg capacity should it fail to go in-service. Milesburg states that there is no evidence on the record that indicates Milesburg would fail if its milestones were extended, or that West Penn could not replace the Milesburg capacity. Milesburg states that arguably ratepayers would be better off if the milestones were extended since they would not pay for capacity until a date closer in 1995. Milesburg states that it would be erroneous to deny the extensions based on the fact that the Commission's Order may be appealed—rather, the modifications should be decided on the merits as opposed to the fear of appeals by industrial intervenors. Milesburg states it was incorrect to link consideration of the request for milestone extensions with the request for capacity rate modifications since each issue should be viewed separately on the merits. Milesburg objects to the fact that the ALJ gave little consideration to the fact that Milesburg has spent substantial time and money to advance its Project, noting that adoption of the ALJ's recommendation would discourage other developers from risking an undertaking in Pennsylvania.

With respect to the ALJ's recommendation to deny the request for increased capacity rates, Milesburg notes that it is merely attempting to duplicate the EEPA that would have been available to it under West Penn's methodology had the regulatory delay been anticipated, and that it is not inconsistent with the serious negotiations standard to use 1986 assumptions with a modified in-service date for the Project. Finally, Milesburg objects to the ALJ's conclusion that the September 1, 1989 Consent

Order bars any modification to the capacity credit since the rates requested are not in excess of the rates in the EEPA corrected for the new in-service date.

With respect to the ALJ's recommendation to modify the methodology utilized for calculating its capacity credit (in the event the Commission ordered extensions to the milestones), Milesburg states that the reduction would be in error since either the Commission's regulations or West Penn's methodology at the time the EEPA was negotiated is the proper benchmark.

OCA's Exceptions regarding the portion of the R.D. pertaining to modifications to capacity credits state that the ALJ's conclusion that the notice issue would not bar an increase is in error. OCA states that notice would have to be given if any significant increase to the originally noticed EEPAs is granted. Armco/Allegheny similarly excepted to this finding.

West Penn's Reply Exceptions addressed Phase II issues for Burgettstown and Milesburg together. A brief description of West Penn's Reply Exceptions on the milestone extensions is set forth in the previous section of this Order. With respect to the requested increase to the capacity rates, West Penn states that Milesburg's argument that updating the rate is not an increase is a strained reading of the Consent Order. West Penn states that the EEPA automatically terminated on February 28, 1989 and that the Commission therefore has no authority under Section 508 to modify it. West Penn states that the Commission has no authority to order a new contract because avoided costs must be determined at the time a legally enforceable obligation is incurred. West Penn asserts that, since the EEPA lapsed, it has no legally enforceable obligation.

OCA's Reply Exceptions do not address the request for extensions to milestone dates. However, OCA supports the recalculation under West Penn's revised methodology of Milesburg's capacity credit, stating that the purpose

of the proceeding is to determine West Penn's avoided costs and set rates accordingly. With respect to Milesburg's request for an increase to its capacity credit, OCA states that if rates are locked in as of the time of serious negotiations they cannot be revised, and to do so would give the QF the best of both worlds. Finally, OCA states that Milesburg's on-line date of January 1990 was 33 months from the date West Penn's rate recovery petition was filed and that it is unlikely that the on-line date would have been met under any circumstances.

Armco/Allegheny's Reply Exceptions state that Section 508 does not empower the Commission to modify a contract that has lapsed and that an increase to rates would violate the September 1, 1988 Consent Order.

The Project's Reply Exceptions take issue with OCA's and Armco/Allegheny's argument that an additional bill insert would be required before granting an increase to the capacity credits. The Projects state that the bill insert provided all interested parties with sufficient notice of the nature of the hearing, and that the ratepayers are well represented in these proceedings. The Projects state that a new notice is not required by the Commission every time an impact is modified during the course of a rate proceeding.

On Milesburg's Phase II issues, we reverse the ALJ. In our opinion the resolution of these issues is clear. We agree with the ALJ that Milesburg's EEPA has lapsed and that modification to the EEPA under Section 508 is a moot point. Nevertheless, Milesburg has been endeavoring to obtain an approved power purchase agreement with West Penn since 1986. Although West Penn does not have a legally enforceable obligation to purchase power under the lapsed 1987 EEPA, it does have a legally enforceable obligation under PURPA 210 to purchase Milesburg's power at rates determined in accordance with West Penn's avoided cost projections in effect in 1986.

The Commission has the responsibility to enforce the provisions of PURPA 210 in Pennsylvania. Milesburg has requested rates based on West Penn's methodology, which we have determined to be the appropriate benchmark of avoided costs in these proceedings. Milesburg has done nothing to waive its entitlement to rates based on avoided costs as of the time of serious negotiations. Therefore, it is our responsibility to require West Penn to enter into a new EEPA with Milesburg, identical in terms with the lapsed EEPA, with extensions to the milestone dates and revised capacity rates that reflect the Project's later in-service date. Specifically, we will require a financing closing date six months after the issuance of a final and nonappealable Order, with similar extensions to related milestones. With respect to the capacity rates, we find no inconsistency with reflecting the Project's later in-service date in the calculation under West Penn's methodology. All of the inputs regarding West Penn's avoided costs will remain the same. The in-service date is not a component of West Penn's avoided costs, or the cost of the 300 MW coal unit, but a component in the calculation of the QF's ability to defer or avoid West Penn's projected costs. West Penn's avoided *costs* do not change with changes in a Project's in-service date. Rather, a change in the in-service date changes the capacity *credit* while keeping West Penn's avoided *costs* constant.

With respect to the issue of whether or not the Consent Orders bars any increase to Milesburg's capacity credit, a reasonable interpretation thereof is that Milesburg agreed to forego an increase based on the six month extension agreed upon by all of the parties. In other words, a reasonable interpretation is that the *quid pro quo* for getting parties to agree to the limited six month extension was Milesburg's agreement not to seek a capacity credit increase based on that particular six months. Therefore, we will deduct six months from the anticipated financing and construction period of 36-42 months and

set the in-service date at 30 months past the issuance of a final and nonappealable Order in this proceeding.

With respect to the use of the revised West Penn formula, we agree with the ALJ that the capacity credit should be calculated using the revision. West Penn "fine tuned" its methodology after the issuance of price proposals to Milesburg. Since we are requiring the execution of a new contract, the revision should be incorporated.

With respect to the suggestion of the ALJ that Milesburg be required to seek a contract in a new evidentiary proceeding under the Commission's regulations, we find that such a requirement would make no sense. Milesburg should not be denied rates based on West Penn's methodology and forced to seek *higher* rates. Moreover, requiring Milesburg to begin anew with another vigorously contested proceeding likely would result in the abandonment of this Project. For the policy reasons set forth in the section of the Order addressing Burgettstown's Phase II proceeding, we find that a failure in this proceeding to recognize and account for regulatory delay would have consequences contrary to the public interest.

Finally, we agree with the ALJ's recommendation regarding the notice issue. The original bill insert provided adequate notice to ratepayers of the nature of these proceedings. We cannot help but note that all of the active parties to these proceedings were before us before the preparation and issuance of the bill insert. In other words, the bill insert elicited no active parties. Therefore, a finding that a new bill insert would be required before granting Milesburg's request for modified capacity rates would elevate form over substance; THEREFORE,

Petition of West Penn Power Company Re: Monongahela Lock and Dam No. 8.

Docket No. P-880283

IT IS ORDERED:

1. That the Petition of West Penn Power Company ("West Penn") for approval of an Electric Energy Purchase Agreement ("EEPA") with Noah Corporation is granted.

2. That the rates established by the EEPA are approved as just, reasonable, and in the public interest.

3. That West Penn is authorized to fully collect all costs paid pursuant to the EEPA through the Energy Cost Rate ("ECR"), or such mechanism as may replace the ECR in the future.

4. That capacity costs paid pursuant to the EEPA will be recovered through the ECR on a demand/energy basis, the particular methodology for which will be established in a separate proceeding that will be initiated after receipt of an advisory report from the Commission's Bureau of Audits.

5. That the addition of capacity under the EEPA does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn capacity.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 21, 1989

ORDER ENTERED: September 29, 1989

Petition of West Penn
Power Company Re: Docket No.
Shannopin Mine Project P-880286

IT IS ORDERED:

1. That the Petition of West Penn Power Company ("West Penn") for approval of an Electric Energy Purchase Agreement ("EEPA") with Mon Valley Energy Corporation is granted.

2. That the rates established by the EEPA are approved as just, reasonable, and in the public interest.

3. That West Penn is authorized to fully collect all costs paid pursuant to the EEPA through the Energy Cost Rate ("ECR"), or such mechanism as may replace the ECR in the future.

4. That capacity costs paid pursuant to the EEPA will be recovered through the ECR on a demand/energy basis, the particular methodology for which will be established in a separate proceeding that will be initiated after receipt of an advisory report from the Commission's Bureau of Audits.

5. That the addition of capacity under the EEPA does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn capacity.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 21, 1989

ORDER ENTERED: September 29, 1989

Petition of West Penn Power Company Re: Burgettstown Project — Docket No. P-880284

IT IS ORDERED:

1. That the Petition of West Penn Power Company ("West Penn") for approval of an Electric Energy Purchase Agreement ("EEPA") with North Branch Energy Partners, L.P. ("North Branch") is granted.

2. That the Petition of North Branch for modification of its EEPA is granted insofar as the Financing Closing Date will be extended to six months after the issuance of a final and nonappealable Order in this proceeding and related contractual milestones will be adjusted accordingly.

3. That North Branch's Application for Stay of the effect the Financing Closing Date is granted.

4. That the rates established by the EEPA are approved as just, reasonable, and in the public interest.

5. That West Penn is authorized to fully collect all costs paid pursuant to the EEPA through the Energy Cost Rate ("ECR"), or such mechanism as may replace the ECR in the future.

6. That capacity costs paid pursuant to the EEPA will be recovered through the ECR on a demand/energy basis, the particular methodology for which will be established in a separate proceeding that will be initiated after receipt of an advisory report from the Commission's Bureau of Audits.

7. That the addition of capacity under the EEPA does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn capacity.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 21, 1989

ORDER ENTERED: September 29, 1989

Petition of West Penn
Power Company Re:
Milesburg Energy, Inc.

Docket No.
P-870216

IT IS ORDERED:

1. That West Penn Power Company ("West Penn") is directed to enter into an Electric Energy Purchase Agreement ("EEPA") with Milesburg Energy, Inc. within thirty (30) days of the date on which this Order becomes final and nonappealable. The terms and conditions shall be identical to the 1987 EEPA with the milestone extensions and capacity credit modifications set forth in the foregoing Order.

2. That the rates established by the resulting EEPA are approved as just, reasonable, and in the public interest.

3. That West Penn is authorized to fully collect all costs paid pursuant to the EEPA through the Energy Cost Rate ("ECR"), or such mechanism as may replace the ECR in the future.

4. That capacity costs paid pursuant to the EEPA will be recovered through the ECR on a demand/energy basis, the particular methodology for which will be established in a separate proceeding that will be initiated after receipt of an advisory report from the Commission's Bureau of Audits.

5. That the addition of capacity under the EEPA does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn capacity.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 21, 1989

ORDER ENTERED: September 29, 1989

APPENDIX O

PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PA 17120

Public Meeting Held September 21, 1989
Agenda No: ALJ-124

Docket No: P-870216 P-880283 P-880284 P-880286

PETITION OF WEST PENN POWER

DISSENTING OPINION OF COMMISSIONER
FRANK FISCHL

I must disagree with the majority's resolution of these issues. Each resolution exposes the ratepayers of West Penn Power to escalating expenses and associated risks from purchases from qualifying facilities.

The Office of Consumer Advocate (OCA) and Armco/ Allegheny Ludlum (AAL) have vigorously contested the level of capacity credits. The credits were derived using West Penn's methodology. The OCA and AAL have challenged the level of credits for a number of reasons. Adoption of any one adjustment would substantially reduce the credit payments. Clearly the credits calculated are above avoided cost and should be reduced.

It is ironic for the majority to conclude that these cogeneration contracts are in the best interest of ratepayers when the OCA, representing residential customers and Armco/Allegheny, two of the largest industrial customers, believe they are not.

The majority further concludes that the reasonableness of the credits is to be judged by a comparison to rates that would be required by the commission's regulations. It is argued that since credits calculated by commission regulation would be per se reasonable, lower credits calculated under West Penn's methodology are per se reasonable as well.

There are two fatal flaws to this argument. The first flaw is that proper application of the commission's regulation indicates that the qualifying facilities should receive no capacity credits whatsoever. (OCA main brief pages 77-80). The second flaw is the lack of discounting to determine the present avoided cost of future capacity additions. (OCA main brief pages 73-74). In fact, reliance on the commission's regulation *guarantees* rates in excess of avoided costs and therefore violates PURPA. The rate calculated by commission regulation cannot be used as a bench mark because the rate will *always* be greater than the rate under West Penn's methodology due to the lack of discounting. Rather than "binding all in Pennsylvania", the regulation should be waived. It is impossible to argue the per se reasonableness of rates based on regulations that do not apply and that involve a defective formula. Avoided cost cannot be defined by regulations.

The resolutions of the so-called Phase II issues are novel and erroneous. Commission regulations clearly state that "nothing in this subchapter will affect existing contracts or future contracts freely entered into by utilities and qualifying facilities." (52 Pa. Code § 57.32) It is unclear why certain sections of our regulations are "binding" while other sections are completely ignored.

The use of milestones is appropriate. Our regulations state: "A qualifying facility is eligible for a capacity credit as stated in this subchapter only if it enters into a contract or other legally enforceable obligation with the purchasing utility including termination notice requirements and sanctions for noncompliance." (52 Pa.

Code § 57.34) The mutually agreed to financial closing milestone for Milesburg passed unfulfilled on March 1, 1989. The contract does not exist; therefore, Section 508 of the Public Utility Code cannot apply. The majority acknowledges as much. The majority; therefore, ordered West Penn to execute a new contract with the developers. They fail to cite any authority for such action, nor in my opinion does such authority exist.

The Commission has previously answered the question of lapsed milestones. (Petitions of Pagnotti Enterprises, Inc. P-860171, P-870281) Pagnotti held that when a qualifying facility does not meet agreed-upon milestones pursuant to a privately negotiated arrangement, the qualifying facility has waived its entitlement to previously available rates and is entitled only to rates based on "later avoided cost projections." Not only is this precedent ignored, the rates to be paid are actually *increased.* The consent order signed by the parties extending the financial closing deadline clearly bars any increase in the capacity. The majority's "reasonable interpretation" that only an increase based on the intervening six months is barred is contrived and without support.

Milesburg's assertion that if required to initiate another proceeding the rates sought would be higher is incorrect. If the Milesburg developers thought for one minute they could compel higher rates through another proceeding, they would have initiated one by now. Per our regulations, Milesburg is not entitled to capacity credits without a contract. (52 Pa. 57.34)

As for the Burgettstown Project, the majority attempts to use Section 508 of the Public Utility Code to justify the stay and extension of the financial closing date. Suffice it to say that if Section 508 has not been challenged previously, it will be challenged now. For support, the majority characterizes a Commonwealth Court decision as an unforseen event, provides a bizarre medical analogy and suggests that any other conclusion "pulls the plug" on

the project. First, Section 508 should not apply. The inability of certain developers to meet voluntarily agreed to milestone dates simply does not rise to a level contrary or adverse to the public interest and general well-being of this Commonwealth. Second, if applied, the modification is effective 30 days after entry of the Commission order. The Electric Energy Purchase Agreement (EEPA) lapsed October 2, 1989. Again, there is no contract to modify.

The majority has misconstrued the Commission's proper role in this case. The Commission has never approved or disapproved a negotiated contract but has simply approved future cost recovery in the energy cost rate or some similar mechanism. As for Milesburg, the Commission has no idea of the rates being approved because "the particular capacity credit cannot be determined at this time." (Motion of Chairman Shane, page 4) The majority does not know how much, only that it is just and reasonable.

To dismiss energy efficiency as "superficially appealing but groundless" is misguided and unfortunate. (Motion of Chairman Shane, page 2). Was not the spirit of PURPA energy efficiency? Where is the efficiency if consumers are charged equal rates whether the source is Milesburg or West Penn Power?

The demand/energy allocation of capacity charges is a red herring. If the contracts were priced appropriately, no incentive would exist for inter-class cost transfer. A rate structure biased against a particular customer class is not the majority's intent, a level of rates biased equally against all customer classes is quite another matter.

As for the recognition of regulatory delay, if the developers are blameless, then who is to blame? Commonwealth Court, this commission? As to the motives of the intervenors, no reason is given, nor does one exist why intervenors would attempt through hearings and appeals to block bargain priced electricity.

The recognition of regulatory delay shifts more risk onto West Penn's ratepayers. An indefinite financial deadline clearly interfers with utilities' ability to plan future generation. The utility could easily end up capacity short or with excess capacity. The lead time necessary for the coal plants supposedly avoided here is about ten years. Planning is impossible in the present situation where these projects are given open-ended deadlines. Blaming regulatory delay is no answer.

In calculating avoided costs for these contracts, West Penn selected a specific time during the negotiation process at which its risk of relying on a project's capacity for planning purposes is significantly reduced. (Order page 13) Obviously then the financial closing dates were chosen under similar conditions. To suggest that the financial closing could occur at late as January 1, 1993 without presenting a risk to West Penn's planning process is grossly in error. Capacity planning is a continual process necessitating constant update and reevaluation. To suggest that West Penn's planning process be held in abeyance until January 1993 or later is absurd. If there is an 80 megawatt hole in West Penn's generation plan; it has been created by the majority decision.

The Commission regulations were intended to equalize the bargaining power of developers vis-a-vis the utilities. The majority have swung the pendulum too far toward the developers and away from the ratepayers who are the final guarantor of the payments and terms approved here.

This decision has eliminated the need for negotiated contracts. Developers can simply dictate terms and have the Commission order the utility to execute the appropriate contract.

/s/ Frank Fischl
FRANK FISCHL
Commissioner

October 6, 1989
Date

APPENDIX P

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held October 27, 1989

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice Chairman
Joseph Rhodes, Jr.
Frank Fischl, dissenting

Docket No. P-880284

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENT AND FOR ORDER GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS RE: BURGETTSTOWN PROJECT

ORDER

BY THE COMMISSION:

On September 29, 1989, our final Order was entered in the above-captioned proceeding. Phase One of this Order generally found that the avoided costs for, *inter alia*, the Burgettstown Project would be determined by utilization of West Penn Power Company's ("West Penn") methodology, and that West Penn's inputs into its methodology were reasonable. Phase Two of this Order extended the financing and related milestones in the electric energy purchase agreement ("EEPA") between West Penn and North Branch Energy Partners, L.P. ("North Branch"), the developer of the Burgettstown Project, and stayed the effect of Section 10.2(c) of the EEPA pending the effective date of our Order

under Section 508 of the Public Utility Code, 66 Pa. C.S. § 508.

Before us for consideration is the Petition for Reconsideration of Armco Advanced Materials Corp. and Allegheny Ludlum Corp. ("Armco/Allegheny") filed October 13, 1989. Armco/Allegheny seek reconsideration of that portion of our Order that stayed the effect of Section 10.2(c) of the EEPA. Armco/Allegheny aver that the stay ordered by the Commission was invalid because contracts can only be varied, reformed or revised. Armco/Allegheny state that "the September 29, 1989 Order was not issued in time to save the Agreement and the purported stay of the Financing Closing Date, which is in reality a contract modification, is invalid." Petition, p. 3. Armco/Allegheny request that West Penn's Petition for approval of the EEPA with North Branch be dismissed.

On October 23, 1989, North Branch filed a Response to Armco/Allegheny's Petition. North Branch avers that Armco/Allegheny have no standing to request reconsideration or to take an appeal from the portion of the order at issue because the date on which North Branch has a closing does not affect rates or service and hence does not affect any substantive rights of Armco/Allegheny. Second, North Branch states that the Commission had the authority to issue the stay as part of its implied powers that are necessary to carry out its express powers, citing Section 501(a) of the Public Utility Code, 66 Pa. C.S. § 501(a) and *Sonafelt v. Pennsylvania Public Utility Commission*, 175 Pa. Superior Ct. 164, 103 A.2d 442 (1954). Third, North Branch states that the Commission has the authority to modify and approve a contract even after the contract's effective date, and may disregard strict time requirements to protect the public. North Branch requests that Armco/Allegheny's Petition for Reconsideration be denied, stating that a grant of reconsideration would further postpone completion of the project and would prejudice North Branch and the public.

DISCUSSION

We will deny the Petition for Reconsideration of Armco/Allegheny. Even if our final Order in this proceeding had been entered after the Financing Closing Date of October 1, 1989 in the North Branch EEPA, for example on October 2, 1989, we simply would have required West Penn to execute a new contract with North Branch, similar to our Order with respect to Milesburg Energy, Inc. at Docket No. P-870216. As we stated therein, West Penn has a legally enforceable obligation under Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3 ("PURPA 210"), to purchase power from a qualifying facility at rates determined in accordance with West Penn's avoided costs projections at the time of serious negotiation. This Commission has the responsibility of enforcing and administering the provisions of PURPA 210. Therefore, whether or not the Financing Closing Date provision of the North Branch EEPA could or could not be stayed is irrelevant to the final determination in this proceeding; namely, that North Branch is entitled to the avoided cost-based rates that it has requested, and that West Penn is entitled to recover costs paid pursuant to these rates from its customers. To hold otherwise would merely elevate form over substance. Moreover, we disagree with Armco/Allegheny's argument that the Commission had no authority to stay the effect of Section 10.2(c) of the North Branch EEPA for thirty days. In essence, we granted equitable relief to North Branch in a situation where the right of North Branch to a contract at the requested rates was clear, where the threat of harm was immediate, and where the prevented injury would have been irreparable. Implicit in our decision was a requirement that West Penn refrain from taking measures to enforce Section 10.2(c) of the EEPA during the thirty day period after which Section 10.2(c) would be revised in accordance with our Order. Armco/Allegheny's position seems to be that the Commission could not enforce PURPA 210 be-

cause of the existence of a self executing contractual provision in the North Branch EEPA that took effect before the Commission's Order under Section 508. This position, if accepted, would mean that, in lieu of ordering a stay and an extension, the Commission would have had to order West Penn to execute a new contract with North Branch. In our opinion acceptance of this position would "put aside substance for needless ceremony." *See Smith v. Illinois Bell Telephone Co.*, 270 U.S. 587, 591 (1926). In *Smith*, the U.S. Supreme Court upheld an order that prohibited, on equitable grounds, a state regulatory commission from enforcing rates set forth in duly approved tariffs. If the exercise of equitable powers can prohibit the enforcement of tariff rates, which have the force and effect of law, it follows that our exercise of equitable powers to prohibit enforcement of the contractual provision at hand and staying the effect thereof pending the effective date of our final Order on the merits was permissible; THEREFORE,

IT IS ORDERED:

1. That the Petition for Reconsideration of Armco Advanced Materials Corp. and Allegheny Ludlum Corp. is denied.

2. That a copy of this Order be entered and served this date upon all parties to the consolidated proceedings at Docket Nos. P-870216, P-880283, P-880284 and P-880286.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: October 27, 1989

ORDER ENTERED: October 27, 1989

APPENDIX Q

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 2090 C.D. 1989

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

No. 2097 C.D. 1989

WEST PENN POWER COMPANY,
Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

Before: HONORABLE JAMES CRUMLISH, JR.,
President Judge
HONORABLE DAVID W. CRAIG, Judge
HONORABLE JAMES GARDNER COLINS, Judge
HONORABLE MADALINE PALLADINO, Judge
HONORABLE BERNARD Y. MCGINLEY, Judge
HONORABLE DORIS A. SMITH, Judge
HONORABLE DAN PELLEGRINI, Judge

ARGUED: APRIL 4, 1990

MEMORANDUM OPINION BY JUDGE CRAIG

FILED: September 7, 1990

North Branch Energy Partners, L.P. (North Branch), proposes to build and operate an electric generating facility near Burgettstown (Burgettstown Project) that would be a qualifying cogeneration facility (QF) within the meaning of section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. § 796.[1]

Armco Advanced Materials Corporation and Allegheny Ludlum Corporation (Armco/Allegheny), two large industrial customers of West Penn Power Company (West Penn), have jointly appealed from an order of the Pennsylvania Public Utility Commission (PUC or Commission) granting West Penn's petition for approval of the terms and conditions of an electric energy purchase agreement (EEPA or contract) between West Penn and North Branch for power from the Burgettstown Project and authorizing recovery from ratepayers of the costs West Penn will incur under the contract. West Penn has appealed separately, and this court has consolidated the appeals.[2]

---

[1] PURPA defines cogeneration facility as one that produces both electric energy and some other form of useful energy, such as heat, 16 U.S.C. § 796(18)(A); a small power production facility has a production capacity of no greater than 80 megawatts (MW) and uses as a primary energy source biomass, waste, geothermal resources or renewable resources such as wind, water or solar energy to produce electric power, § 796(17)(A). Together they are known as "qualifying facilities" or QFs.

[2] These appeals are closely related to other appeals by Armco/Allegheny and West Penn from the PUC's order, in the same opinion, involving an EEPA between West Penn and Milesburg Energy, Inc., for the Milesburg Project, *West Penn Power Co. v. Pennsylvania Public Utility Commission*, —— Pa. Commonwealth Ct. ——, —— A.2d —— (Nos. 2074 and 2092 C.D. 1989, filed July 17, 1990) (*Milesburg II*), and an appeal by Armco/Allegheny only from the PUC's order regarding an EEPA between West Penn and the Mon Valley Energy Corporation for the Shannopin Project, *Armco Advanced Materials Corporation v. Pennsylvania Public Utility Commission* (No. 2091 C.D. 1989, filed July 17, 1990).

The principal questions presented are (1) whether the PUC had the authority to order payment to a QF of capacity credits reflecting avoided costs calculated as of a time before the QF had made a commitment to deliver capacity,[3] and (2) whether the PUC had the authority, under the section of the Public Utility Code granting the Commission power to modify contracts or any other authority, to extend milestone dates in the submitted EEPA so as to prevent the automatic termination of the agreement.

Our scope of review of PUC adjudications is limited to determining whether constitutional rights were violated, an error of law was committed or a finding of fact was not supported by substantial evidence in the record. 2 Pa. C.S. § 704; *T.W. Phillips Gas and Oil Co. v. Pennsylvania Public Utility Commission,* 81 Pa. Commonwealth Ct. 205, 208, 474 A.2d 355, 358 (1984).

History

North Branch and West Penn began negotiating in August of 1985 concerning North Branch's proposal to build a generating facility in Robinson Township, Washington County, capable of providing up to 80 MW of power for a period of thirty-three years and using steam generated by the facility to recover carbon dioxide from

---

[3] Energy costs are the variable costs associated with the production of electric energy—the cost of fuel and some operating and maintenance expenses. Capacity costs are those associated with providing the capability to deliver energy—primarily the capital costs of facilities. If a QF offers energy of sufficient reliability and with sufficient legally enforceable guarantees of deliverability to permit the purchasing electric utility to avoid the need to construct a generating unit, to build a smaller, less expensive plant or to reduce firm power purchases from another utility, then the rates for such a purchase will be based on the avoided energy and capacity costs. 45 Fed. Reg. 12216 (February 25, 1980). Where a state regulatory authority must compel a utility to purchase from a QF, the rates are to be based on the full avoided cost (FAC). 18 C.F.R. § 292.304(b)(2).

the boiler flue gas. The facility is to be fueled by coal waste located on some 450 acres at the project site. In May of 1986 West Penn quoted rates for the purchase of power from the project, and North Branch agreed to those rates in June. Negotiations continued, and North Branch proceeded with design engineering, began finalizing a financing plan (which included seeking tax exempt government bond financing), entered into an agreement with a contractor for construction on a turnkey contract basis, and applied for certification by the Federal Energy Regulatory Commission (FERC) as a QF under PURPA.

On October 15, 1987, North Branch and West Penn executed the EEPA, which provided for a levelized capacity credit of 3.6¢ per kilowatt hour (KWH), based on an in-service date of October of 1991. The EEPA included various milestone dates designed to assure West Penn that satisfactory progress was being made on the project, including a "Financing Closing Date", defined as the date of the first closing of the initial construction financing. The contract provided, in section 10.2(c), that the agreement would automatically terminate if the financing closing date did not occur before October 1, 1989, for any reason whatsoever, including Force Majeure, and, apart from West Penn's right to retain good faith deposits then held, neither party would have any further liability to the other. Section 5.3 of the EEPA contained conditions precedent to West Penn's obligations as of the financing closing date, including the existence of a PUC order or rule, final beyond appeal, establishing that West Penn's entry into the contract was in full compliance with the law and public policy of Pennsylvania, that the purchase would not result in excess capacity, and that all amounts paid by West Penn under the contract were consistent with law and could be immediately and fully passed through to ratepayers.

On January 5, 1988, West Penn filed a petition with the PUC (approval petition) seeking an order declaring

that the EEPA complied with section 210 of PURPA, 16 U.S.C. § 824a-3, and with the Public Utility Code and that West Penn was authorized to pass through all costs under it. The approval petition also requested that the PUC provide notice and a comment period relating to the order, to satisfy due process rights of ratepayers and so to prevent future collateral attack. Without providing notice or an opportunity to be heard, the Commission issued a Tentative Opinion and Order on July 8, 1988, granting the approval petition and authorizing rate recognition of the costs.

This court issued an opinion on August 22, 1988, in the case of *Barasch v. Pennsylvania Public Utility Commission,* 119 Pa. Commonwealth Ct. 81, 546 A.2d 1296, *reargument denied,* 119 Pa. Comomnwealth Ct. 115, 550 A.2d 527 (1988) (*Milesburg I*). We held there that before the PUC may approve the legality of a contract for a utility's purchase of power from a QF that includes substantial payments for capacity, due process requires that the utility's customers must be provided with notice of the proceedings and an opportunity to be heard to challenge the proposed action, because such approval is adjudicatory in nature and involves substantial property rights of ratepayers.

On September 30, 1988, the PUC consolidated for hearing purposes the Burgettstown Project approval petition and those relating to the Shannopin Project and another project. Although this court stated on November 3, 1988, in denying the PUC's request for reargument in *Milesburg I,* that the rule of that case would be applied only prospectively, the Commission consolidated the Milesburg Project petition with the other three and assigned them all to the Office of Administrative Law Judge for hearing.

On April 3, 1989, North Branch filed a petition requesting modification of the EEPA (modification petition), stating that, because of delays in the disposition

of the approval petition, especially the scheduling of the hearing before an Administrative Law Judge (ALJ), North Branch would not be able to meet the existing financing closing date. North Branch requested that the PUC exercise its powers under section 508 of the Public Utility Code, 66 Pa. C.S. § 508,[4] to modify the EEPA by defining the financing closing date to be six months from the date of a final order of the PUC in the proceeding, and adjusting related milestone dates accordingly.[5]

The ALJ conducted a hearing on the four consolidated cases over eight days in April of 1989. He bifurcated the proceeding into Phase One, concerning issues relating to the proper capacity rates to be paid to the QFs, and Phase Two, concerning issues raised by the modification petition of North Branch and a similar petition filed by Milesburg Energy, Inc.

On June 8, 1989, the ALJ issued a Recommended Decision holding, on the Phase One issues, that the "time of agreement in principle on price" employed by West Penn in regard to each of the EEPAs satisfied the PUC's standard of time of "serious negotiations" between the parties as the time as of which avoided costs should be determined, and he approved the serious negotiation standard itself. On the Phase Two issue, the ALJ recom-

---

[4] Section 508 authorizes the PUC to vary, reform or revise, upon a fair, reasonable and equitable basis, any obligations, terms or conditions of any contract between a utility and a person, corporation or municipal corporation that embrace or concern a public right or are affected or concerned with the public interest. The Commission shall determine, after reasonable notice and hearing, that such obligations, terms or conditions are unjust, unreasonable, inequitable or otherwise contrary to the public interest and general well-being of the Commonwealth, and it shall prescribe proper terms. The modified contract takes effect thirty days after service of the PUC's order on the parties.

[5] The modification petition also requested an increase in the capacity credit, but North Branch later withdrew that request after the ALJ issued his decision and before the PUC issued its decision.

mended that the modification petition of North Branch be denied, stressing the evidence in the record relating to the need for utilities to be able to plan their capacity additions in an orderly fashion, the open-ended nature of the requested modifications to the milestone dates and the fact that the parties accepted various risks in the original negotiations.

On August 17, 1989, because the financing closing date of October 1, 1989, was soon approaching and the PUC had not yet ruled on the case, North Branch filed an "Application for A Stay of the Financing Closing Date."

The PUC entered an opinion and order on this case on September 29, 1989. The Commission adopted the ALJ's recommendations on the Phase One issues, including that of the time as of which avoided costs are to be calculated. On the Phase Two issues relating to the Burgettstown Project EEPA, the PUC reversed the ALJ's recommendation and granted the modification petition. Because section 508 of the Public Utility Code provides that a PUC order modifying a contract shall take effect thirty days after it is entered, the Commission granted the August 17 request for a stay of the effect of section 10.2(c) of the EEPA.

Armco/Allegheny filed a petition for reconsideration, which the Commission denied by order entered October 27, 1989.

Phase One—Time Frame

On the Phase One issue, the PUC reiterated its long-standing policy that avoided costs are to be determined as of the time of serious negotiations between the parties. The Commission noted with approval the ALJ's comment that no matter what time is used to fix EEPA capacity purchase rates, the ratepayers bear a risk that the avoided costs will go down, and the QFs bear a risk that they will go up. The Commission rejected Armco/Allegheny's argument that time of contract execution should control. The PUC agreed with West Penn's argument that time

of agreement in principle on price was reasonable, and it agreed with the QFs' contention that deviation from the Commission's longstanding practice would undermine the PUC's credibility and would turn avoided costs into a constantly moving target. Armco/Allegheny has continued its challenge to the serious negotiations standard on this appeal.[6]

Our decision on this issue is controlled by our decision in the related case of *West Penn Power Co. v. Pennsylvania Public Utility Commission*, —— Pa. Commonwealth Ct. ——, —— A.2d —— (Nos. 2074 and 2092 C.D. 1989, filed July 17, 1990) (*Milesburg II*). As we noted in *Milesburg II*, 18 C.F.R. § 292.304(d)(2), promulgated by FERC pursuant to its mandate from Congress to implement the provisions of PURPA, provides that where a QF exercises its option to provide energy or capacity pursuant to a contract or other "legally enforceable obligation" for the delivery of energy or capacity over a specified term, the rate for such purchases shall, at the option of the QF exercised before the beginning of the term, be based on either the full avoided costs calculated at the time of delivery or calculated at the time the obligation is incurred.

Concurring with recent decisions from other jurisdictions, we concluded that, under § 292.304(d)(2), the time when a QF executes a contract with a utility, or when it otherwise does everything in its power to create a legally enforceable obligation to deliver energy or capacity, is the time as of which the PUC must calculate the avoided costs for the purpose of determining the legality of contract rates submitted for its approval.[7] The

---

[6] Although West Penn presented most of the evidence at the hearing in favor of the serious negotiation standard, it has now joined Armco/Allegheny in arguing that that standard violates the FERC regulations.

[7] *See, e.g., Snow Mountain Pine Co. v. Mauldin*, 84 Or. App. 590, 599, 734 P.2d 1366, 1371, *review denied*, 303 Or. 591, 639 P.2d 571

question is not whether the serious negotiations standard is reasonable but rather whether that standard complies with the FERC regulations that the PUC is charged to implement. The fact that a QF does have the power to fix the time for calculating avoided costs, after which conditions almost certainly will change, does not mean that any time at all may be used. Changing from a standard that does not comply with the FERC regulations to one that does comply does not mean that the standard may be changed on a case-by-case basis. Although the value of full avoided costs may become a moving target, it will be so only until time of execution of the contract.

That fact may make negotiations more difficult, but that is the scheme that FERC has chosen. The PUC's serious negotiations standard is contrary to the FERC regulations; consequently, that standard must be abandoned. In the present case, as in the related appeals, the PUC's approval of capacity credits based on a calculation of avoided costs as of a time before the QF had incurred a legally enforceable obligation to delivery capacity was error.[8]

(1987) (QF's self-imposed obligation to deliver energy triggers utility's obligation to purchase, with avoided costs determined from the date the QF obligates itself), and *Appeal of Public Service Co. of New Hampshire*, 130 N.H. 285, 292, 539 A.2d 275, 279 (1988) (PUC's articulated policy of treating the filing of a rate petition accompanied by an interconnection agreement signed by small power producer as a legally enforceable obligation is consistent with 18 C.F.R. § 292.304(d)(2)).

[8] The foregoing analysis does not imply that any person or entity, whether or not actually able to provide electric energy or capacity, has the power to lock in avoided cost rates simply by tendering a contract or petitioning the PUC to compel a purchase. In *Empire Lumber Co. v. Washington Water Power Co.*, 114 Idaho 191, 755 P.2d 1229 (1987), a lumber company proposing to produce electric power from burning waste wood products filed a complaint with the state PUC to compel a utility to purchase, after negotiations between the parties were unsuccessful. The state

Phase Two—Modification and Stay

The Commission reversed the ALJ on the Phase Two issues relating to the Burgettstown Project. The Commission noted that the application for approval of the EEPA for that project had been before it since January of 1988, but that unforeseen circumstances, principally the holding

---

PUC, noting that lumber company had no specific sized plant or configuration for the project in mind, declined to issue such an order, holding that the company at no time was ready, willing and able to sign a contract with the utility. The Idaho Supreme Court affirmed, concluding that PURPA did not require an electric utility to enter into a contract to purchase power from an entity that in essence only desired to obtain an option to sell some amount of power to be generated at some plant of unknown size or capacity, and that substantial evidence supported the PUC's determination.

The record in the present proceeding, Burgettstown Statement #5-B, Rebuttal Testimony of Raymond J. Hoehler, 3-7; R. 484a-88a, describes the extensive activities taken by North Branch toward developing the project *after* the agreement in principle on price. Those activities included selecting a suitable location for the plant site from the 1,000-acre area controlled by the project, testing and studying the feedstock fuel to determine its quantity, quality and suitability for use in the fluidized bed boiler, conducting a test burn of the feedstock fuel in the boiler to determine its burning characteristics, emission levels and nature of ash residue, engaging consulting engineers to prepare applications for an ash disposal permit and an air quality construction permit, beginning initial design engineering work for the project, retaining the services of a financial consultant and bond counsel for the purpose of seeking tax-exempt bond financing from Washington County and the state, entering into an agreement with Westinghouse Electric Company to construct the project on a turnkey basis, retaining counsel from Washington, D.C., to assist in securing QF certification of the project from FERC, and organizing the entities that constitute North Branch Energy Partners, L.P., the owners of the project, and finalizing corporate organizational and contractual matters among them. Had North Branch petitioned the PUC at the time of agreement in principle on price, we doubt that the PUC could properly have ordered West Penn to purchase, in view of the many fundamental aspects of the project that were unresolved at that time.

of the hearing after this court's decision in *Milesburg I*, had made it impossible for North Branch to meet the milestone dates. The Commission stated that granting the approval petition would be pointless if the contract were permitted to terminate automatically two days later. The PUC believed that recognizing regulatory delay and prohibiting such delay from determining the fate of a project was essential. In addition, the Commission rejected Armco/Allegheny's suggestion that North Branch could simply start over with a new approval petition, because that also would give substantive effect to procedural delays. The PUC ordered that the EEPA milestone dates be modified in accordance with the request by North Branch, and it ordered that the section of the EEPA requiring a financial closing by October 1, 1989, be stayed, so as to give the modification order time to take effect.

West Penn's first challenge to the PUC's order is based on an assertion that any attempted modification of the contract by the PUC is preempted by 18 C.F.R. § 292.301 (b). That regulation states that nothing in the FERC rules "limits the authority of any utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart . . . ." West Penn's position reveals a fundamental misunderstanding on its part of the nature of these proceedings. Although § 292.301(b) and the PUC regulation implementing the federal rule, 52 Pa. Code § 57.32, permit private, independent negotiation of utility-QF contracts, and endorse the legality and enforceability of such contracts even if the terms differ from those prescribed, those regulations apply to privately negotiated contracts that are fully consummated without regulatory involvement.

Where a utility conditions its obligations under a negotiated agreement on approval from the state PUC, and submits the contract to obtain such approval, the situa-

tion is *not* the private negotiation and agreement contemplated by § 292.301(b). Rather, such a proceeding is more nearly like one in which a QF simply petitions the state PUC to compel a utility to comply with its duty under PURPA to purchase from the QF, which in effect requires the PUC to write a contract for the parties. In such a case the PUC may not impose a term or condition for the purchase that is contrary to FERC's rules and to PURPA itself. Similarly, where one or both parties to a negotiated contract submit it for formal PUC approval, the PUC may not approve rates or any other terms of the contract in conflict with PURPA.

In the case of a submitted contract, the PUC must evaluate all of the terms and conditions, not just those relating to rates. Where the PUC identifies contractual terms in conflict with PURPA or the FERC regulations, the PUC has the power under PURPA to modify those terms, independently of any state authority to modify utility contracts generally.[9] This fundamental principle relates to many of the arguments raised by West Penn and Armco/Allegheny in this case. An attempt by the PUC to use its section 508 power to modify in an independently negotiated and executed utility-QF contract, *not conditioned on PUC approval,* would be preempted by § 292.301(b); however, that concept is not applicable to these proceedings.

West Penn next raises a constitutional challenge to the validity of section 508 of the Public Utility Code, arguing that the section's grant of power to the Commission to

---

[9] We agree with the contention of North Branch that FERC's broad delegation of power to state regulatory agencies, necessarily permits the state agencies to bring to bear all of their state statutory powers (such as the Commission's section 508 power to modify contracts) when they are called on to evaluate submitted utility-QF contracts. However, we believe that the mandate from Congress and FERC to state agencies to implement the goals of PURPA also confers federal power that is not constrained by the details and peculiarities of each state agency's state authority.

modify obligations, terms or conditions of utility contracts that are affected or concerned with the public interest, when the PUC determines that "any such obligations, terms, or conditions are adverse to the public interest and the general well-being of this Commonwealth" lacks sufficiently well defined standards to constitute a valid act of delegation by the legislature.

Although the Commission's order entered September 29, 1989, made reference only to section 508, the order denying reconsideration, entered October 27, 1989, included a federal law rationale for the Commission's action. The reconsideration order stated that even if the PUC's final order had been entered *after* the financing closing date, the Commission would have had the power to order West Penn to enter into a new contract with North Branch, as the Commission had done in regard to the lapsed contract between West Penn and Milesburg Energy, Inc., relating to the Milesburg Project. The Commission stated that its authority for such action was its responsibility to enforce and administer the provisions of section 210 of PURPA in Pennsylvania.

We have already approved the PUC's ordering West Penn to enter into a new contract regarding the Milesburg Project in *Milesburg II*. We held there that the power the PUC was exercising was its power under section 210 of PURPA, rather than any authority under state law. That holding applies to the Commission's action in regard to the North Branch EEPA as well. Although the PUC did not at first correctly articulate the authority for its action, its order denying the petition for reconsideration remedied that problem. The PUC was not exercising state authority pursuant to section 508 of the Public Utility Code when its extended the miliestone dates in the North Branch EEPA. Accordingly, there is no reason for this court to consider the constitutionality of section 508. Of course, a court should not decide a constitutional question if the case before it may be decided on nonconstitutional grounds. *Lattanzio v. Unemployment*

Compensation Board of Review, 461 Pa. 392, 336 A.2d 595 (1975); *Friedlander v. Zoning Hearing Board of Sayre Township*, 119 Pa. Commonwealth Ct. 164, 546 A.2d 755 (1988).

West Penn and Armco/Allegheny [10] both contend that the PUC failed to make the determination required by section 508 that the rigid milestone dates in the original contract were "contrary or adverse to the public interest and general well-being of this Commonwealth . . . ." Our conclusion that the PUC was not exercising section 508 authority in extending the milestone dates renders this issue moot. Nevertheless, we observe that the effect of PURPA is to make the encouragement of the development of cogeneration and small power production an aspect of the public interest of this Commonwealth and of the nation as a whole. The PUC in these proceedings thoroughly considered both the specific economic and environmental benefits of this particular project and the PURPA requirement of encouraging the development of QFs generally. Contrary to the assertion of West Penn, the Commission's action in modifying the milestone dates was not interference in a general management decision of the utility but was intimately connected with the PUC's role of regulating the utility's public service obligation, as that role has been expanded by PURPA.

West Penn and Armco/Allegheny assert that the PUC erred or abused its discretion by ordering indefinite mile-

---

[10] We reject the contention of North Branch that Armco/Allegheny lacks standing to appeal as to the Phase Two issues in this case. As we noted in *Milesburg I*, where the PUC approves a utility-QF contract providing for a capacity credit, the effect is the same as the Commission's approving costs of the utility's own construction in a rate case. Under the circumstances of this case, the determination of the propriety of the milestone extensions will have the effect of deciding whether this project proceeds or whether it terminated automatically on October 1, 1989. Armco/Allegheny has a sufficient interest in that outcome to confer standing on the milestone extension issues as well as the rate issues.

stone dates in the modified North Branch EEPA, because fixed milestones are necessary for the protection of West Penn and its ratepayers. As we noted in *Milesburg II*, the Commission has not eliminated the use of milestone dates altogether. Rather, the Commission has extended the first of those dates to a time six months after the entry of a nonappealable order in this case and has adjusted related dates accordingly. We held in *Milesburg II* that the PUC had the discretion under PURPA and the FERC regulations to require such an extension for the purpose of assuring that litigation delays do not become the factor that determines whether a project proceeds or fails. Although the extension may disrupt West Penn's planning to a certain degree, the PUC had the power to weigh the planning interest against the PURPA interest and to decide as it did.

West Penn argues that it anticipates a shortage of electric energy in the near future in our region of the country, and that it must have certainty in its planning so as not to be caught short of capacity and thereby forced to purchase expensive replacement power. We agree with the PUC's observation on this point. Noting that failure to grant the extension would leave an 80 MW shortfall in West Penn's generation plans, the Commission said:

> To date North Branch has completed substantial development work and the lengthy review process by the Commission finally has been completed. North Branch is ready to proceed to financing, barring any appeals of our Order. Therefore, to in essence 'pull the plug' on the Burgettstown Project at this late stage would inject the very uncertainty in West Penn's generation plans that it seeks to avoid.

Re West Penn Power Co., —— Pa. P.U.C. at ——, 106 PUR 4th at 478.

West Penn and Armco/Allegheny both argue forcefully that the PUC lacked the power under section 508 or any other grant of authority to order a "stay" of the financing closing date so as to allow for the passage of the thirty days specified in section 508 before a contract modification under that section is effective. We readily agree that, unfortunately, neither agencies nor courts possess the power to stay the passing of time. As discussed above, however, the Commission's action in modifying the North Branch EEPA was not an exercise of its section 508 power, and it was not constrained by the thirty-day provision of that section.

Finally, West Penn contends that the PUC's modification of the milestone dates in the contract violated the principle of substantive due process because, West Penn asserts, the PUC acted to confer a purely private benefit upon North Branch. West Penn notes that the police power of government must always and only be exercised in the public interest, and not for the benefit of an individual. Had the PUC acted on the basis of no discernible legislative authority, West Penn's argument would have merit. However, as has been stated several times, the PUC acted pursuant to its power and duty under PURPA to encourage the development of cogeneration and small power production.

West Penn's argument here therefore really amounts to an attack on PURPA itself; however, the benefits conferred on QFs under PURPA are no different from loans or tax exemptions or credits or other benefits that inure to private persons or entities in the service of clearly identified public policies. *See, e.g., Cleveland v. United States,* 323 U.S. 329 (1945) (United States Housing Act of 1937, 42 U.S.C. §§ 1401-1436, providing for loans, contributions and grants to public housing agencies for the creation of low-cost housing projects and exempting property developed under its provisions from state taxation in furtherance of the purposes of the federal legisla-

tion, was constitutional as within the power of Congress to provide for the general welfare). At this late date the validity of PURPA is beyond question. The PUC's order in this case was a proper exercise of its power under PURPA and the FERC regulations; therefore, the PUC did not violate the principle of substantive due process.

Conclusion

Having concluded that the "time of serious negotiations" standard for determining at what point a utility's avoided costs should be calculated represents a violation of the FERC regulations, we shall reverse the PUC's order on this point. We shall remand to the Commission with instructions that the PUC calculate the capacity cost credit for North Branch according to West Penn's method, using inputs appropriate for the time when West Penn and North Branch executed their contract. The PUC must produce a calculation that is binding upon it, and it must make that calculation part of the record of this proceeding. If the calculated capacity credit is lower than the rate to which North Branch previously agreed, the PUC must offer North Branch the opportunity to decline to proceed with the project. For due process reasons, the PUC must communicate its calculation of avoided costs to the parties and permit the submission of written objections, should any party wish to challenge the accuracy of the calculation.

The PUC properly exercised its authority under the FERC regulations implementing PURPA to order a modification of the contract submitted for approval by West Penn to provide for a financing closing date six months from the date of entry of a nonappealable order in this case, with appropriate extensions to related milestone dates. We affirm the Commission's order on this point.

Because this case involves a question of first impression, the resolution of which could not have been clearly

foreshadowed, our intention is that the decision shall have only prospecitve effect. *Chevron Oil Co. v. Huson*, 404 U.S. (1971).

/s/ David W. Craig
DAVID W. CRAIG
Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

No. 2090 C.D. 1989

ARMCO ADVANCED MATERIALS CORPORATION and ALLEGHENY LUDLUM CORPORATION,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

ORDER

NOW, September 7, 1990, the Order of the Pennsylvania Public Utility Commission at Docket No. P-880284, entered September 29, 1989, is affirmed in part and modified in part. The order is modified so that the Electric Energy Purchase Agreement between West Penn Power Company and North Branch Energy Partners, L.P., that the Commission approved shall be modified to provide a calculation of capacity cost credit, reflecting factors in existence at the time the EEPA was executed, October 15, 1987, rather than at the time of serious negotiations between the parties. The order is affirmed in all other respects.

This case is remanded to the Commission with instructions for the Commission to make a new calculation of capacity cost credit, according to the method of calculation employed by West Penn throughout these proceedings, with the adjustment for monthly rather than yearly payments noted in the Commission's opinion. Such calculation shall use inputs appropriate for October 15, 1987. In addition, the financing closing date shall be six months from the time that the Commission's order be-

comes final and nonappealable, and all other milestone dates shall be adjusted accordingly. The Commission shall make its calculation of avoided costs part of the record of this proceeding, and it shall supply copies to the parties, allowing a reasonable period for the submission of written objections to the calculation. Should the new capacity rate prove to be less than that to which the parties initially agreed, the PUC shall offer North Branch the opportunity to decline to proceed with the project.

Jurisdiction relinquished.

/s/ David W. Craig
DAVID W. CRAIG
Judge

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 2097 C.D. 1989

WEST PENN POWER COMPANY,
Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

ORDER

NOW, September 7, 1990, the Order of the Pennsylvania Public Utility Commission at Docket No. P-880284, entered September 29, 1989, is affirmed in part and modified in part. The order is modified so that the Electric Energy Purchase Agreement between West Penn Power Company and North Branch Energy Partners, L.P., that the Commission approved shall be modified to provide a calculation of capacity cost credit, reflecting factors in existence at the time the EEPA was executed, October 15, 1987, rather than at the time of serious negotiations between the parties. The order is affirmed in all other respects.

This case is remanded to the Commission with instructions for the Commission to make a new calculation of capacity cost credit, according to the method of calculation employed by West Penn throughout these proceedings, with the adjustment for monthly rather than yearly payments noted in the Commission's opinion. Such calculation shall use inputs appropriate for October 15, 1987. In addition, the financing closing date shall be six months from the time that the Commission's order becomes final and nonappealable, and all other mile-

stone dates shall be adjusted accordingly. The Commission shall make its calculation of avoided costs part of the record of this proceeding, and it shall supply copies to the parties, allowing a reasonable period for the submission of written objections to the calculation. Should the new capacity rate prove to be less than to which the parties initially agreed, the PUC shall offer North Branch the opportunity to decline to proceed with the project.

Jurisdiction relinquished.

/s/ David W. Craig
DAVID W. CRAIG
Judge

APPENDIX R

THE SUPREME COURT OF PENNSYLVANIA
WESTERN DISTRICT

CHARLES W. JOHNS, ESQUIRE
Prothonotary
IRMA T. GARDNER
Deputy Prothonotary

801 City-County Building
Pittsburgh, Pa.
15219-2463
(412) 565-2816

November 20, 1991

Drew Kovalak, Esquire
West Penn Power Company
800 Cabin Hill Drive
Greensburg, PA 15601

David F. Boehm, Esquire
Boehm, Kurtz & Lowry
2110 Society Bank Center
36 East Seventh Street
Cincinnati, OH 45202

J. Tomlinson Fort, Esquire
Reed, Smith, Shaw & McClay
P.O. Box 2009
Pittsburgh, PA 15230

Terrence F. McVerry, Esquire
Grogam, Graffam, McGinley & Lucchino, P.C.
22nd Floor
Three Gateway Center
Pittsburgh, PA 15222

In Re: Armco Advanced Materials Corporation, et al. v. Pennsylvania Public Utility Commission/West Penn Power Company v. Pennsylvania Public Utility Commission
No. 531 W. D. Allocatur Docket 1990

Gentlemen:

The Court has entered the following Order on your Petitions for Allowance of Appeal in the above-captioned matter:

"November 19, 1991
Petition Denied
Per Curiam"

Very truly yours,

/s/ Irma T. Gardner
Deputy Prothonotary

APPENDIX S

THE SUPREME COURT OF PENNSYLVANIA
WESTERN DISTRICT

CHARLES W. JOHNS, ESQUIRE
Prothonotary
IRMA T. GARDNER
Deputy Prothonotary

801 City-County Building
Pittsburgh, Pa.
15219-2463
(412) 565-2816

February 3, 1992

Michael D. McDowell, Esquire
West Penn Power Company
800 Cabin Hill Drive
Greensburg, PA 15601

Lee E. Morrison, Esquire
PA Public Utility Commission
P.O. Box 3265
North Office Building
Harrisburg, PA 17120

In Re: Armco Advanced Materials Corporation, et al.
v. Pennsylvania Public Utility Commission
No. 0531 W. D. Allocatur Docket 1990

Gentlemen:

The Court has entered the following Order on your Applications for Reconsideration of Denial of Allowance of Appeal in the above-captioned matter:

"PER CURIAM

AND NOW, this 3rd day of February, 1992, the Applications for Reconsideration filed on behalf of West Penn Power Company and Pennsylvania Public Utility Commission are denied."

Very truly yours,

/s/ Irma T. Gardner
Deputy Prothonotary

APPENDIX T

Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3. Cogeneration and small power production

(a) Cogeneration and small power production rules

Not later than 1 year after November 9, 1978, the Commission shall prescribe, and from time to time thereafter revise, such rules as it determines necessary to encourage cogeneration and small power production, and to encourage geothermal small power production facilities of not more than 80 megawatts capacity, which rules require electric utilities to offer to—

(1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities and

(2) purchase electric energy from such facilities.

Such rules shall be prescribed, after consultation with representatives of Federal and State regulatory agencies having ratemaking authority for electric utilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments. Such rules shall include provisions respecting minimum reliability of qualifying cogeneration facilities and qualifying small power production facilities (including reliability of such facilities during emergencies) and rules respecting reliability of electric energy service to be available to such facilities from electric utilities during emergencies. Such rules may not authorize a qualifying cogeneration facility or qualifying small power production facility to make any sale for purposes other than resale.

(b) Rates for purchases by electric utilities

The rules prescribed under subsection (a) of this section shall insure that, in requiring any electric utility to

offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purchase—

(1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

(2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

No such rule prescribed under subsection (a) of this section shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.

(c) Rates for sales by utilities

The rules prescribed under subsection (a) of this section shall insure that, in requiring any electric utility to offer to sell electric energy to any qualifying cogeneration facility or qualifying small power production facility, the rates for such sale—

(1) shall be just and reasonable and in the public interest, and

(2) shall not discriminate against the qualifying cogenerators or qualifying small power producers.

(d) "Incremental cost of alternative electric energy" defined

For purposes of this section, the term "incremental cost of alternative electric energy" means, with respect to electric energy purchased from a qualifying cogenerator or qualifying small power producer, the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source.

(e) Exemptions

(1) Not later than 1 year after November 9, 1978, and from time to time thereafter, the Commission shall, after consultation with representatives of State regulatory authorities, electric utilities, owners of cogeneration facilities and owners of small power production facilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments, prescribe rules under which geothermal small power production facilities of not more than 80 megawatts capacity, qualifying cogeneration facilities, and qualifying small power production facilities are exempted in whole or part from the Federal Power Act [16 U.S.C.A. § 791a et seq.], from the Public Utility Holding Company Act [15 U.S.C.A. § 79 et seq.], from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production.

(2) No qualifying small power production facility (other than a qualifying small power production facility which is an eligible solar, wind, waste, or geothermal facility as defined in section 796(17)(E) of this title) which has a power production capacity which, together with any other facilities located at the same site (as determined by the Commission), exceeds 30 megawatts, or 80 megawatts for a qualifying small power production facility using geothermal energy as the primary energy source, may be exempted under rules under paragraph (1) from any provision of law or regulation referred to in paragraph (1), except that any qualifying small power production facility which produces electric energy solely by the use of biomass as a primary energy source, may be exempted by the Commission under such rules from the Public Utility Holding Company Act [15 U.S.C.A.

§ 79 et seq.] and from State laws and regulations referred to in such paragraph (1).

(3) No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—

(A) any State law or regulation in effect in a State pursuant to subsection (f) of this section,

(B) the provisions of section 210, 211, or 212 of the Federal Power Act [16 U.S.C.A. § 824i, 824j, or 824k] or the necessary authorities for enforcement of any such provision under the Federal Power Act [16 U.S.C.A. § 791a et seq.], or

(C) any license or permit requirement under part I of the Federal Power Act [16 U.S.C.A. § 791a et seq.], any provision under such Act related to such a license or permit requirement, or the necessary authorities for enforcement of any such requirement.

(f) Implementation of rules for qualifying cogeneration and qualifying small power production facilities

(1) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) of this section or revised under such subsection, each State regulatory authority shall, after notice and opportunity for public hearing, implement such rule (or revised rule) for each electric utility for which it has ratemaking authority.

(2) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) of this section or revised under such subsection, each nonregulated electric utility shall, after notice and opportunity for public hearing, implement such rule (or revised rule).

(g) Judicial review and enforcement

(1) Judicial review may be obtained respecting any proceeding conducted by a State regulatory authority or nonregulated electric uitlity for purposes of implementing any requirement of a rule under subsection (a) of this section in the same manner, and under the same requirements, as judicial review may be obtained under section 2633 of this title in the case of a proceeding to which section 2633 of this title applies.

(2) Any person (including the Secretary) may bring an action against any electric utility, qualifying small power producer, or qualifying cogenerator to enforce any requirement established by a State regulatory authority or nonregulated electric utility pursuant to subsection (f) of this section. Any such action shall be brought only in the manner, and under the requirements, as provided under section 2633 of this title with respect to an action to which section 2633 of this title applies.

(h) Commission enforcement

(1) For purposes of enforcement of any rule prescribed by the Commission under subsection (a) of this section with respect to any operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility which are subject to the jurisdiction of the Commission under part II of the Federal Power Act [16 U.S.C.A. § 824 et seq.], such rule shall be treated as a rule under the Federal Power Act [16 U.S.C.A. § 791a et seq.]. Nothing in subsection (g) of this section shall apply to so much of the operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility as are subject to the jurisdiction of the Commission under part II of the Federal Power Act.

(2)(A) The Commission may enforce the requirements of subsection (f) of this section against any State

regulatory authority or nonregulated electric utility. For purposes of any such enforcement, the requirements of subsection (f)(1) of this section shall be treated as a rule enforceable under the Federal Power Act [16 U.S.C.A. § 791a et seq.]. For purposes of any such action, a State regulatory authority or nonregulated electric utility shall be treated as a person within the meaning of the Federal Power Act. No enforcement action may be brought by the Commission under this section other than—

(i) an action against the State regulatory authority or nonregulated electric utility for failure to comply with the requirements of subsection (f) of this section or

(ii) an action under paragraph (1).

(B) Any electric utility, qualifying cogenerator, or qualifying small power producer may petition the Commission to enforce the requirements of subsection (f) of this section as provided in subparagraph (A) of this paragraph. If the Commission does not initiate an enforcement action under subparagraph (A) against a State regulatory authority or nonregulated electric utility within 60 days following the date on which a petition is filed under this subparagraph with respect to such authority, the petitioner may bring an action in the appropriate United States district court to require such State regulatory authority or nonregulated electric utility to comply with such requirements, and such court may issue such injunctive or other relief as may be appropriate. The Commission may intervene as a matter of right in any such action.

(i) Federal contracts

No contract between a Federal agency and any electric utility for the sale of electric energy by such Federal agency for resale which is entered into after November 9, 1978, may contain any provision which will have the effect of preventing the implementation of any rule under

this section with respect to such utility. Any provision in any such contract which has such effect shall be null and void.

(j) New dams and diversions

Except for a hydoelectric project located at a Government dam (as defined in section 3(10) of the Federal Power Act [16 U.S.C.A. § 796(10)]) at which non-Federal hydroelectric development is permissible, this section shall not apply to any hydroelectric project which impounds or diverts the water of a natural watercourse by means of a new dam or diversion unless the project meets each of the following requirements:

(1) No substantial adverse effects

At the time of issuance of the license or exemption for the project, the Commission finds that the project will not have substantial adverse effects on the environment, including recreation and water quality. Such finding shall be made by the Commission after taking into consideration terms and conditions imposed under either paragraph (3) of this subsection or section 10 of the Federal Power Act [16 U.S.C.A. § 803] (whichever is appropriate as required by that Act [16 U.S.C.A. § 791a et seq.] or the Electric Consumers Protection Act of 1986) and compliance with other environmental requirements applicable to the project.

(2) Protected rivers

At the time the application for a license or exemption for the project is accepted by the Commission (in accordance with the Commission's regulations and procedures in effect on January 1, 1986, including those relating to environmental consultation), such project is not located on either of the following:

(A) Any segment of a natural watercourse which is included in (or designated for potential inclusion in) a State or national wild and scenic river system.

(B) Any segment of a natural watercourse which the State has determined, in accordance with applicable State law, to possess unique natural, recreational, cultural, or scenic attributes which would be adversely affected by hydroelectric development.

(3) Fish and wildlife terms and conditions

The project meets the terms and conditions set by fish and wildlife agencies under the same procedures as provided for under section 30(c) of the Federal Power Act [16 U.S.C.A. § 823a(c)].

(k) Definition of new dam or diversion

For purposes of this section, the term "new dam or diversion" means a dam or diversion which requires, for purposes of installing any hydroelectric power project, any construction, or enlargement of any impoundment or diversion structure (other than repairs or reconstruction or the addition of flashboards or similar adjustable devices).

(l) Definitions

For purposes of this section, the terms "small power production facility", "qualifying small power production facility", "qualifying small power producer", "primary energy source", "cogeneration facility", "qualifying cogeneration facility", and "qualifying cogenerator" have the respective meanings provided for such terms under section 3(17) and (18) of the Federal Power Act [16 U.S.C.A. § 796(17), (18)].

APPENDIX U

Regulations Adopted By FERC, 18 C.F.R. §§ 292.301 & 304 (1993).

Subpart C—Arrangements Between Electric Utilities and Qualifying Cogeneration and Small Power Production Facilities Under Section 210 of the Public Utility Regulatory Policies Act of 1978

§ 292.301 Scope.

(a) *Applicability.* This subpart applies to the regulation of sales and purchases between qualifying facilities and electric utilities.

(b) *Negotiated rates or terms.* Nothing in this subpart:

(1) Limits the authority or any electric utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart; or

(2) Affects the validity of any contract entered into between a qualifying facility and an electric utility for any purchase.

* * * *

§ 292.304. Rates for purchases.

(a) *Rates for purchases.* (1) Rates for purchases shall:

(i) Be just and reasonable to the electric consumer of the electric utility and in the public interest; and

(ii) Not discriminate against qualifying cogeneration and small power production facilities.

(2) Nothing in this subpart requires any electric utility to pay more than the avoided costs for purchases.

(b) *Relationship to avoided costs.* (1) For purposes of this paragraph, "new capacity" means any purchase from

capacity of a qualifying facility, construction of which was commenced on or after November 9, 1978.

(2) Subject to paragraph (b)(3) of this section, a rate for purchases satisfies the requirements of paragraph (a) of this section if the rate equals the avoided costs determined after consideration of the factors set forth in paragraph (e) of this section.

(3) A rate for purchases (other than from new capacity) may be less than the avoided cost if the State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or the nonregulated electric utility determines that a lower rate is consistent with paragraph (a) of this section, and is sufficient to encourage cogeneration and small power production.

(4) Rates for purchases from new capacity shall be in accordance with paragraph (b)(2) of this section, regardless of whether the electric utility making such purchases is simultaneously making sales to the qualifying facility.

(5) In the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.

(c) *Standard rates for purchases.* (1) There shall be put into effect (with respect to each electric utility) standard rates for purchases from qualifying facilities with a design capacity of 100 kilowatts or less.

(2) There may be put into effect standard rates for purchases from qualifying facilities with a design capacity of more than 100 kilowatts.

(3) The standard rates for purchases under this paragraph:

(i) Shall be consistent with paragraphs (a) and (e) of this section; and

(ii) May differentiate among qualifying facilities using various technologies on the basis of the supply characteristics of the different technologies.

(d) *Purchases "as available" or pursuant to a legally enforceable obligation.* Each qualifying facility shall have the option either:

(1) To provide energy as the qualifying facility determines such energy to be available for such purchases, in which case the rates for such purchases shall be based on the purchasing utility's avoided costs calculated at the time of delivery; or

(2) To provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:

(i) The avoided costs calculated at the time of delivery; or

(ii) The avoided costs calculated at the time the obligation is incurred.

(e) *Factors affecting rates for purchases.* In determining avoided costs, the following factors shall, to the extent practicable, be taken into account:

(1) The data provided pursuant to § 292.302(b), (c), or (d), including State review of any such data;

(2) The availability of capacity or energy from a qualifying facility during the system daily and seasonal peak periods, including:

(i) The ability of the utility to dispatch the qualifying facility;

(ii) The expected or demonstrated reliabiltiy of the qualifying facility;

(iii) The terms of any contract or other legally enforceable obligation, including the duration of the obligation, termination notice requirement and sanctions for non-compliance;

(iv) The extent to which scheduled outages of the qualifying facility can be usefully coordinated with scheduled outages of the utility's facilities;

(v) The usefulness of energy and capacity supplied from a qualifying facility during system emergencies, including its ability to separate its load from its generation;

(vi) The individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system; and

(vii) The smaller capacity increments and the shorter lead times available with additions of capacity from qualifying facilities; and

(3) The relationship of the availability of energy or capacity from the qualifying facility as derived in paragraph (e)(2) of this section, to the ability of the electric utility to avoid costs, including the deferral of capacity additions and the reduction of fossil fuel use; and

(4) The costs or savings resulting from variations in line losses from those that would have existed in the absence of purchases from a qualifying facility, if the purchasing electric utility generated an equivalent amount of energy itself or purchased an equivalent amount of electric energy or capacity.

(f) *Periods during which purchases not required.* (1) Any electric utility which gives notice pursuant to paragraph (f)(2) of this section will not be required to purchase electric energy or capacity during any period during which, due to operational circumstances, purchases from qualifying facilities will result in costs greater than those which the utility would incur if it did not make

such purchases, but instead generated an equivalent amount of energy itself.

(2) Any electric utility seeking to invoke paragraph (f)(1) of this section must notify, in accordance with applicable State law or regulation, each affected qualifying facility in time for the qualifying facility to cease the delivery of energy or capacity to the electric utility.

(3) Any electric utility which fails to comply with the provisions of paragraph (f)(2) of this section will be required to pay the same rate for such purchase of energy or capacity as would be required had the period described in paragraph (f)(1) of this section not occurred.

(4) A claim by an electric utility that such a period has occurred or will occur is subject to such verification by its State regulatory authority as the regulatory authority determines necessary or appropriate, either before or after the occurrence.

APPENDIX V

Regulations Adopted By Pennsylvania PUC, 52 Pa. Code § 57.32 (1983).

§ 57.32. Purpose and scope.

(a) *Purpose.* The purpose of this subchapter is to implement the provisions of section 210 of the Public Utility Regulatory Policies Act of 1978, Public Law 95-617, Title II, § 210, 92 Stat. 3144 (16 U.S.C.A. § 824a-3(a)-(j)). To this end, this subchapter details the requirements that utilities and qualifying facilities will have to meet concerning the filing of utility system cost data, the methodology to be used in establishing rates for sales and purchases, the responsibility for interconnection costs, the standards for system safety and reliability, and the processes by which the Commission will attempt to resolve disputes between utilities and qualifying facilities. This subchapter is intended to equalize the bargaining power of qualifying facilities with that of the utilities and protect the interests of the ratepayers. Nothing in this subchapter requires a qualifying facility to take advantage of the provisions of this subchapter. It is up to the qualifying facility to decide whether or not it wants to do so. Furthermore, as detailed in subsection (c), nothing in this subchapter will affect existing contracts or future contracts freely entered into by utilities and qualifying facilities. Long term contracts are encouraged.

(b) *Applicability.* This subchapter governs the purchases and sales of energy or energy and capacity between qualifying facilities and electric utilities.

(c) *Negotiated contracts.*

(1) Nothing in this subchapter:

(i) limits or extends the authority of any electric utility to agree to a price for any purchase or to terms or conditions relating to any purchase which differ from the

terms or conditions which would otherwise be required by this subchapter; or

(ii) affects the validity of any contract entered into between a qualifying facility and an electric utility for any purchase to the extent such contract is valid and in compliance with applicable statutes and regulations.

(2) Each utility shall file with the Commission a copy of any contract or agreement that it enters into with a qualifying facility with a design capacity of 500 kilowatts or more.